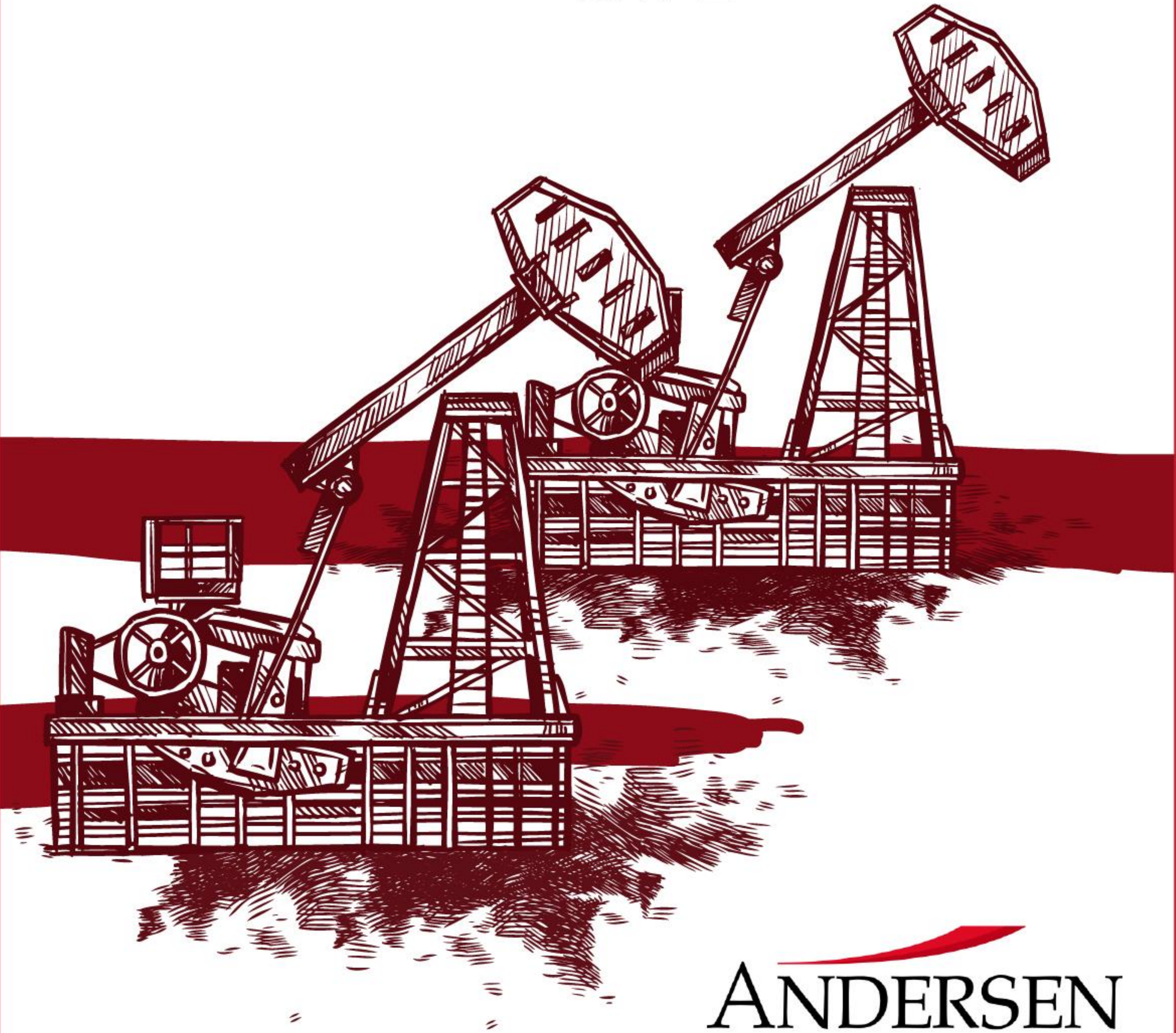
# Guide to Taxation for Oil and Gas in Egypt



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# Introduction

The oil and gas sector play a vital role in the Egyptian economy, contributing significantly to national income and attracting foreign investment. However, it remains one of the most regulated sectors, subject to complex tax obligations. Understanding the tax framework governing oil and gas activities in Egypt is essential for companies operating in this sector, as it involves various types of taxes and financial arrangements.

Egypt often utilizes Production Sharing Agreements (PSAs) to regulate the relationship between the state and international companies. Under these agreements, the international company assumes exploration risks and is entitled to a portion of the production upon achieving commercial discoveries. A part of the production is allocated for cost recovery, with the remainder shared between the company and the state according to the agreed terms.

# I. Oil Sector

Oil (petroleum) refers to crude oil in all its densities, asphalt, gas emitted from reservoirs, and all other hydrocarbons found, extracted, or obtained in any other manner from the area. It also includes all substances that may be derived from it, as well as the crude oil and hydrocarbons produced in a liquid state at the wellhead or gas separation points, or those extracted from gas or emitted from reservoirs at any facility, including distilled products and condensates.

## Tax Obligations of the Oil Sector

### Corporate Income Tax:

Oil companies in Egypt are subject to corporate income tax on profits derived from exploration, production, refining, extraction, transportation, distribution, import, and export of petroleum and its derivatives, including motor oils, fuels, base oils, and additives. These profits are taxed at a special rate of 40.55%, higher than the general rate for other sectors, which stands at 22.5%. However, profits of the Egyptian General Petroleum Corporation (EGPC) are taxed at 40%.

### Value-Added Tax (VAT):

The oil sector enjoys several exemptions and incentives under Law No. 67 of 2016. Article 18 of the list of exempted goods and services provides direct exemptions, along with the following additional incentives:

## 1- VAT Exemptions:

### A. Crude Oil:

Refers to the natural raw material (not a final product and not subject to any industrial process). If any substance or industrial process is added that alters its original state, it becomes subject to the general VAT rate of 14%.

### B. Natural Materials, Including Products from Mines and Quarries in Their Natural State:

For example, the exploration and extraction of phosphate ore.

## 2- Law No. 11 of 1991:

This law exempts agreements concluded between the Egyptian government and foreign countries, international or regional organizations, or petroleum or mining agreements.

## 3- Egyptian General Petroleum Corporation (EGPC):

EGPC and all companies owned by or under its supervision, engaged in the exploration, extraction, and production of petroleum, are exempt from VAT. Article 8 of Law No. 112 of 1985 stipulates that the General Petroleum Company is exempt from any taxes related to the extraction, production, export, or transportation of petroleum.

## **4- Petroleum Concession Agreements:**

Petroleum concession agreements exempt many companies from VAT on purchases of local goods and services, provided these relate to petroleum exploration, development, extraction, production, export, or transportation within a specified area, with an exemption certificate issued in the name of the area. However, non-exempt items listed in the approved guideline by EGPC and the relevant authority are excluded.

**The exemption is subject to the following conditions:**

- The agreements must remain valid without any amendments affecting the exemption clauses.
- The granted exemption must not be used for purposes other than those for which it was provided.
- Exempt goods must not be disposed of within five years following the exemption.
- Suppliers of goods and services must be informed of the list.

## 5- Revenues in Kind:

Revenues can be collected in kind, for example, exchanging crude oil with other crude oil.

## 6- Training and Healthcare Services for Others:

Training and healthcare services provided to others are subject to specific tax provisions.

## Schedule Tax:

The legislature has included petroleum products within the **Schedule Tax** list, subject to taxation only under this framework. Specific petroleum products and related services will follow the guidelines and rates outlined within the Schedule Tax.

## Table Tax on Oil Products

### Excise Tax Table

The legislator classified oil products under a special Excise Tax schedule:

| No. | Commodity | Tax Treatment based on VAT Law | | |
|---|---|---|---|---|
| | | collection unit | Tax rate | |
| 2 | **Oil Products:** | | Piaster | EGP |
| | (a) Gasoline: | | | |
| | 1. Gasoline-80 Octane (imported) | Liter | 3.0 | - |
| | 2. Gasoline-80 Octane (local) | Liter | 18.00 | - |
| | 3. Gasoline-90 Octane (imported) | Liter | 48.00 | - |
| | 4. Gasoline-90 Octane (local) | Liter | 63.00 | - |
| | 5. Gasoline-92 Octane (imported) | Liter | 48.00 | - |
| | 6. Gasoline-92 Octane (local) | Liter | 65.00 | - |
| | 7. Gasoline-95 Octane (imported) | Liter | 3.0 | 1 |
| | 8. Gasoline-95 Octane (local) | Liter | 20.0 | 1 |
| | (b) Kerosene | Liter | 36.0 | - |
| | (c) Solar | Liter | 36.0 | - |
| | (d) Diesel Oil | Liter | 0.8 | - |
| | (e) Fuel Oil (Mazut) | Ton | 50.0 | - |

It is noteworthy that private sector companies (branches of foreign companies operating in Egypt) purchase these products from the Egyptian General Petroleum Corporation (EGPC), as it is the sole supplier of these products. The EGPC is responsible for reporting the schedule tax (excise tax) due on the products mentioned in the above table and remitting it to the Egyptian Tax Authority. Consequently, these companies (branches of foreign companies operating in Egypt) do not collect taxes on such items. This type of tax is predominantly reflected at fuel stations according to oil calibration standards and aircraft fueling processes.

## Non-deductibility of Taxes and Their Treatment as Costs

We wish to emphasize that taxes should not be deducted but rather treated as part of the cost since they are used to produce goods subject only to schedule tax.
However, if the company's activities include oils and fuels, the following must be considered:

- Oils: Companies are entitled to deduct input taxes related to oil activities, such as (base oils, packaging, machinery spare parts, oil customer incentives, machinery, oil storage services, maintenance services, oil transport services, and fuel station rentals for third parties).

- Fuels: Companies are not entitled to deduct input taxes related to fuel activities.

## Input Tax Deduction

### Deductibility of Fixed Asset Taxes:

The company is entitled to deduct input tax on fixed assets (such as pumps necessary for refining activities) provided that:

- These assets are owned by the company.
- They are used exclusively in the production of taxable items.

### Withholding Tax:

Withholding tax applies to payments to foreign contractors and service providers. Typically, a withholding tax rate of 20% applies to services rendered by foreign companies to Egyptian oil and gas companies, unless a lower rate is stipulated under a double taxation avoidance agreement.

### Royalties:

In addition to corporate income tax, oil and gas companies are required to pay royalties to the Egyptian government. The royalty rate is usually around 10% of the total production, and these royalties are paid before any other deductions. Royalties serve as compensation to the state for extracting natural resources.

## II. Gas Sector Operations

The activities of companies operating in Egypt's gas sector include the establishment, manufacture, operation, maintenance, management, and ownership of gas pipelines, installations, and facilities, along with all equipment and systems required for this purpose. These companies are also engaged in purchasing natural gas, preparing it for consumption, selling it, and managing unified gas networks. They blend and package mineral oils using basic mineral oils supplied by EGPC, along with locally sourced or imported oils with specific characteristics, which vary among companies.

# Tax Obligations in the Gas Sector:

Corporate Income Tax: Gas exploration and production companies in Egypt are subject to corporate income tax, which is imposed on their profits at a rate of 40.55%.

Value-Added Tax (VAT): VAT is the most significant tax among others, as the principle of VAT involves the deduction of input tax. Given the variety of gases, such as butane, propane, ethane-propane mixtures, condensates, ethylene, and polyethylene, companies must separate taxable inputs from exempt ones. The deduction criterion applies only to taxable inputs.

| Related Activity | Type of Service/Revenue | Tax Rate |
|---|---|---|
| Maintenance and connection services for customers' networks | Maintenance and gas network connections | 14% |
| Supervision of oil and gas projects | Supervision project revenues | 14% |
| Shipping services and others | Revenues from services sold | 14% |
| Refining petroleum products and other services | Operation revenues for third parties | 14% |
| Inspection of gas pipelines within Egypt | Gas pipeline inspection revenues (in Egypt) | 14% |
| Transportation and distribution of gas | Gas transportation and distribution revenues | 14% |
| Sale of waste materials | Waste sales revenues | 14% |
| Construction contracts for gas network supply and installation | Gas network construction contracts | 5% |
| Consultancy services for oil and gas companies | Consultancy services revenues | 10% |
| Inspection of gas pipelines abroad | Gas pipeline inspection revenues (outside Egypt) | 0% |

# Exempt Gases

Butane gas (LPG) is exempt under item 19 of the list of exempt goods and services in Law No. 67 of 2016, provided no other component is added or mixed with it.

## Deductibility of Input Tax:

Input tax on fixed assets may be deducted if the following conditions are met:

- The assets are owned by the company.
- They are used exclusively in the production of taxable items.
- If such assets are used in both taxable and exempt activities, input tax can be deducted in proportion to taxable sales and services to total sales.

# Tax Challenges, Ambiguities, and Disputes with the Egyptian Tax Authority

## 1. Multiple Petroleum Products and VAT Applicability

A primary principle of VAT is the general rate of 14%. Products listed under the schedule tax are excluded from the general rate for social, political, or economic considerations. Therefore, any petroleum or gas derivatives not included in the exempt list or under the schedule tax are subject to the general rate.

## 2. Tax Refunds

Obtaining tax refunds for export-related inputs presents challenges for oil companies, given the complexity of submitting production formulas under Instruction No. 90 of 2021. However, with a clear understanding of the nature of inputs and outputs, experience with similar operations, and familiarity with the Egyptian Tax Authority's requirements, it becomes easier to meet refund requirements. Refunds play a crucial role in ensuring liquidity, enabling companies to purchase raw materials or invest in new machinery, and maintain operations by covering rental obligations and staff bonuses. Proper management of tax refunds enhances the company's financial position and operational sustainability.

## Importance of Understanding Tax Obligations:

Enhances the company's reputation and avoids penalties.
Optimizes tax incentives and benefits, attracting further investment by ensuring proper understanding and application of tax laws.

## 3. Compensation and Late Penalties from Suppliers

Compensation and penalties imposed on suppliers for delays in fulfilling contracts are contractual matters that do not fall under VAT regulations.

## 4. Employee Secondment Services

Due to the specialized nature of the oil sector, companies often second employees to one another. However, secondment services are not considered labor supply contracts and are subject to VAT under Article 3 of the Executive Regulations of Law No. 67 of 2016, which lists non-taxable services exhaustively. Labor supply, excluding agricultural labor, is taxable at the general rate of 14%.

## 5. Condensates

Condensates are often misunderstood as primary crude oil. Once crude oil undergoes mixing or processing, it no longer qualifies as exempt crude oil and is subject to the general VAT rate of 14%.

## 6. Tax Differences on Write-Offs (Waste or Losses)

Given the extensive exploration and research activities in the oil and gas sector, waste and losses are common. Companies must obtain a letter from the General Authority for Industrial Control specifying the acceptable loss ratio to avoid disputes during tax audits.

## 7. Sales to Exempt Entities

Some companies sell products to exempt entities (e.g., the Armed Forces, Ministry of Interior, Sukari Mine, Egyptian Aviation Services, and exempt oil companies) without obtaining exemption certificates. This can lead to tax disputes during audits. Companies should safeguard their right to tax settlement upon obtaining the necessary exemption documents.

## 8. Revenues from Trademarks and Related Parties' Transactions

### Understanding Trademark Revenues

In the oil and gas industry, many foreign companies lease their fuel stations to other entities, often related parties. These leases typically involve the use of the company's trademark, for which a fee is charged. This trademark revenue is subject to VAT at the general rate of 14%.

### Transfer Pricing Compliance

To ensure that these transactions are conducted at arm's-length prices, oil and gas companies must adhere to transfer pricing regulations. This is particularly important when dealing with related-party transactions, as there is a risk of artificially inflating or deflating prices to manipulate profits and tax liabilities.

### Key Transfer Pricing Considerations

Arm's-Length Principle: The transfer pricing of trademark revenues should be consistent with the prices that would be charged between independent parties in comparable circumstances.

- Comparable Uncontrolled Transactions (CUTs): Identifying comparable transactions between independent parties can be challenging in the oil and gas industry, especially for unique trademarks or specific geographic locations.

- Benchmarking: Using benchmarking techniques to compare the trademark revenue to similar transactions in the industry can help establish an arm's-length range.
- Functional Analysis: Analyzing the functions performed, assets employed, and risks assumed by the parties involved in the trademark transaction can help determine the appropriate allocation of profits.
- Documentation: Maintaining comprehensive documentation to support the transfer pricing methodology and demonstrate compliance with tax regulations is essential.

## Conclusion

The Egyptian oil and gas industry operate in a complex tax landscape that requires careful oversight. Companies face a range of tax obligations, including corporate income tax, royalties, VAT, and production-sharing agreements. A thorough understanding of these obligations is essential to ensure regulatory compliance and enhance financial efficiency.

By closely following transfer pricing regulations, businesses can reduce tax exposure and ensure accurate reporting of revenues. Moreover, a strong grasp of the evolving regulatory framework allows companies to manage their tax commitments effectively, contributing to the long-term stability and growth of Egypt's oil and gas sector.

**Prepared By:**

Mohamed Shabaan – Tax Senior

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