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## Construction and Engineering Focus Team

## Cairo Team

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**Construction and Engineering Focus Team**



***Focus Team Leader***
Paolo Daino
paolo.daino@belex.com
Tel. +39-02-771131

**Cairo Team**



***Team Leaders***
Ziad Bahaa-Eldin
ziad.bahaaeldin@belex.com
Tel. +202 25867503

Gianfranco Veneziano
gianfranco.veneziano@belex.com
Tel. +39 02 771131

Riccardo Bicciato
riccardo.bicciato@belex.com
Tel. +202 25867506

Francesca Secondari
francesca.secondari@belex.com
Tel. +202 25867519



***Authors***
Riccardo Bicciato
riccardo.bicciato@belex.com
Tel. +202 25867506

Michele Dimonte
michele.dimonte@belex.com
Tel. +39-02-771131

Mostafa Elfar
mostafa.elfar@belex.com
Tel. +39-02-771131


# EPC contracts and indirect tax treatment in Egypt

Foreign construction companies entering or intending to enter into engineering, procurement and construction ("**EPC**") contracts involving services that are partially performed outside Egypt (e.g., engineering) often face difficulties in understanding the indirect tax treatment applicable to these contracts. This article sheds light on the indirect tax aspects foreign contractors should consider when entering into EPC contracts in Egypt.

## 1. Legal framework

The legal framework governing the indirect tax treatment applicable to EPC contracts is made up of:

- Law No. 67/2016 ("**VAT Law**"),[1] which replaces the General Sales Tax Law (No. 11/1991);[2] and
- Executive Regulations of the VAT Law issued by Ministry of Finance Decree No. 66/2017 ("**Executive Regulations**"),[3] which provide additional rules and procedures for the application of the VAT Law.

## 2. Differences between the two indirect taxes in the VAT law

The VAT Law introduces two forms of indirect taxes:

- VAT, which applies in a similar way to VAT under European systems; and
- 'schedule tax', a form of excise tax that applies only to the goods and services listed in the schedules annexed to the VAT Law ("**Schedule Tax**"). The schedules include two categories of goods

[1] Value-Added Tax Law No. 67/2016, published in the Official Gazette, Issue No. 35-*bis*, 7 September 2016.
[2] See Art. 2 of the VAT Law's implementing provisions, repealing the General Sales Tax Law, published in the Official Gazette, Issue No. 18-*bis*(a), 2 May 1991.
[3] Ministry of Finance Decree No. 66/2017, which enacted the Executive Regulations, Official Gazette, Issue No. 55-*cont.*(a), 7 March 2017.


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and services: (a) those subject to Schedule Tax only (e.g., professional or consultancy services),[4] and (b) those subject to Schedule Tax and VAT.[5]

The differences in scope and application between the VAT and Schedule tax are not always clear to foreign construction companies. The following sections provides an outline of these differences in the following areas: (a) rates; (b) what constitutes a taxable event; (c) whether it is possible to deduct indirect tax charged on inputs; and (d) whether the taxpayer is required to register with the Egyptian tax authority ("**ETA**").

### A. Rates and categories

The VAT applies at a general rate of 14%.[6] Schedule Tax applies at different rates depending on the category of the good/service in question (e.g., 10% for professional or consultancy services).[7] The applicable Schedule Tax rate depends on various factors, including whether: (a) the good is locally produced or imported; and (b) the tax is imposed ad valorem or as an amount per unit.

### B. Taxable event

The taxable event for Schedule Tax purposes is the sale, supply or importation of goods or services listed in the two schedules annexed to the VAT Law.[8]

However, unlike VAT, which applies to all stages of circulating a good or service,[9] Schedule Tax is due only once: upon the first sale, supply or importation of the relevant good/service to the client (e.g., for EPC contracts, the project owner).[10]

### C. Possibility of deducting indirect tax charged on inputs

VAT incurred on purchases of inputs (i.e., goods/services) ("**Input VAT**")[11] can be deducted from the VAT to be charged by the taxpayer to its customer or final consumer, as the case may be ("**Output VAT**").[12] However, Input VAT cannot be deducted from the Schedule Tax.[13] The taxpayer's deduction of indirect taxes borne on inputs from those charged

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[4] Schedule No. 1.
[5] Schedule No. 2.
[6] Art. 3(1) of the VAT Law.
[7] Art. 36(1) of the VAT Law: "The schedule tax shall be according to the rates or values indicated opposite the goods and services listed in the schedule …" (unofficial translation).
[8] Art. 36(1) of the VAT Law.
[9] Art. 5(1) of the VAT Law.
[10] Art. 38(1) of the VAT Law. For the taxable event in EPC contracts, please see section III.D.
[11] As defined in Art. 1 of the VAT Law.
[12] Art. 22(1) of the VAT Law and item (2) of Art. 26(1) of the Executive Regulations.
[13] Item (1) of Art. 22(3) of the VAT Law, Art. 27(1) of the Executive Regulations and Art. 28(2) of the Executive Regulations.

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to clients depends on whether these goods sold or services supplied are subject to Output VAT or Schedule Tax.[14]

> Although Input VAT can thus be deducted from Output VAT, non-deductible Input VAT must, for Schedule Tax purposes, be recorded as a cost in the client's/final consumer's annual financial statements.

### D. Requirement to register with the ETA for indirect tax purposes

The VAT Law requires taxpayers engaged in selling a good or supplying a service listed in the schedules to register with the ETA for Schedule Tax purposes, regardless of the taxpayer's sales volume and annual turnover.[15] Conversely, taxpayers must register for VAT purposes only when the sales volume or annual turnover exceeds the registration threshold.[16] The registration procedures are the same for both taxes.[17]

Taxpayers whose business involves the sale of goods or the supply of services subject to both Schedule Tax and VAT must register with the ETA for VAT purposes.[18]

## 3. The indirect tax treatment applicable to EPC contracts

To help foreign contractors assess the applicability of Schedule Tax on EPC contracts in light of the VAT Law and its ER, this section provides an overview of: (a) the scope of Schedule Tax on EPC contracts; (b) what constitutes a taxable person; (c) the applicable rate; (d) what constitutes a taxable event; and (e) the taxable base.

### A. Scope of Schedule Tax on EPC contracts

Schedule no. 1 annexed to the VAT Law lists 13 goods and services subject only to Schedule Tax (i.e., not subject to VAT). Among these, item (9) expressly refers to "contracting works, building and construction works (supply and installation)".

Art. 76(1) of the Executive Regulations defines "contracting works, building and construction works" as services that include both: (a) supply,[19] and (b) installation. The Executive Regulations lists 10 examples, including: (a)

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[14] Item (1) of Art. 22(3) of the VAT Law, Arts. 27(1) and 28(2) of the Executive Regulations.

[15] Art. 41 of the VAT Law. See also Art. 51 of the Executive Regulations, which describes the registration procedures for taxpayers engaged in selling a good or supplying a service listed in the schedules with the ETA for Schedule Tax purposes.

[16] Art. 16 of the VAT Law details when registration is mandatory for VAT purposes. Art. 16(1) of the VAT Law sets a registration threshold of EGP 500,000.

[17] Arts. 19 and 51 of the Executive Regulations.

[18] Art. 20 of the Executive Regulations.

[19] To understand what is meant by "supply", reference can be made to the rulings of the Egyptian administrative courts on the definition of a "supply contract", i.e., an agreement between the state or any of its bodies/entities and a private enterprise whereby the latter supplies movable property to the former for a price. The same notion is relevant for the purposes of applying Schedule Tax to private (non-administrative) contracts.

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civil construction works; (b) infrastructure works; and (c) electromechanical, electronic and telecommunication works.

In each case, only contracts for works and services that include both supply and installation ("**Contracting Works**") are subject to Schedule Tax. Item (1) of Art. 76(2) of the Executive Regulations stipulates that "if it is a contract of supply without installation, or vice versa, it shall be excluded from the concept of contracting indicated in item (9) … and shall be subject to the rates and categories stipulated by law".[20] This means, in practice, that if the contract in question entails only the supply of goods or an installation service, the only indirect tax applicable to that contract is VAT (in accordance with applicable rules), not Schedule Tax.

### B. Taxable person

The VAT Law defines "taxable person" and "registrant" for indirect tax purposes.[21] Based on these definitions, if the works performed under an EPC contract qualify as Contracting Works, a general contractor (i.e., a supplier of Contracting Works that are listed in schedule no. 1) must register with the ETA for Schedule Tax purposes, regardless of its annual turnover.

Conversely, if the works under the EPC contract in question do not qualify as Contracting Works, the general rules on registering with the ETA for VAT purposes apply.

> A distinction must be made between two cases, namely whether the total value of the EPC contract in question is exclusive or inclusive of indirect taxes. If exclusive, the supplier of the Contracting Works charges the indirect taxes to the project owner on top of the invoice amount (i.e., the project owner bears the indirect taxes); if inclusive of indirect taxes, the supplier of the Contracting Works issues an invoice without adding any charges for indirect taxes (i.e., the supplier bears the indirect taxes).

### C. Rate

Under schedule no. 1 of the VAT Law, the Schedule Tax applies to EPC contracts at the rate of 5% for works that qualify as Contracting Works; general VAT rates apply if they do not. [22]

### D. Taxable event

Contracting Works are considered a "service of a continuous nature", which the Executive Regulations defines as "services that are rendered on a regular, uninterrupted basis to satisfy the needs of their beneficiaries"[23]

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[20] Item (1) of Art. 76(2) of the Executive Regulations (unofficial translation).
[21] Art. 1 of the VAT Law.
[22] Art. 3(1) of the VAT Law.
[23] Art. 43(1) of the Executive Regulations.

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and, more generally, services that, by their nature, require time to be completed.[24] Thus, a project owner hires a third-party consultant (an engineer) whose responsibilities include: (a) monitoring works progress in view of the timetable; (b) monitoring compliance with the agreed specifications; (c) approving the works; and (d) instructing the project owner to pay the contractor at the agreed milestones.

Under item (2) of Art. 76(2) of the Executive Regulations, with respect to EPC contracts that qualify as Contracting Works, the taxable event for – the purposes of the Schedule Tax on – is when the consultant approves payment of an agreed milestone.[25]

If the works do not qualify as Contracting Works, general VAT rules on the taxable event apply.[26]

### E. Taxable base

Under schedule no. 1 of the VAT Law, the taxable base for an EPC contract for works that qualify as Contracting Works is the total value of that EPC contract. For each invoice, the taxable base is the value of the milestone approved by the consultant.[27] The taxable base in EPC contracts for Schedule Tax purposes "must include the local and imported supplies of goods and services involved in the contract works",[28] regardless of who the supplier is (i.e., awarding body/entity, general contractor or subcontractors).

If the works do not qualify as Contracting Works, general VAT rules on the taxable base apply.[29]

## 4. Construction

Foreign construction companies entering or planning to enter into EPC contracts in Egypt must carefully assess the indirect tax treatment applicable to their prospective EPC contract. As demonstrated above, this treatment will vary depending on the work to be performed by the contractor. Having a clear understanding of the indirect tax treatment will not only allow foreign EPC contractors to ensure efficient contract management from a tax perspective but also help it prepare competitive bids.

Lastly, although outside the scope of this newsletter, the direct tax treatment of any EPC contract must certainly also be assessed based on the foreign contractor's domestic income tax law, any applicable double tax treaty, and the guidelines and positions of the ETA.

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[24] Art. 43(2) of the Executive Regulations lists examples of "services of a continuous nature", which include: (a) communication and fax services, and (b) construction and building contract services.
[25] Art. 33 of the VAT Law and Art. 43 of the Executive Regulations.
[26] Art. 5(1) of the VAT Law and Art. 7(1) of the Executive Regulations.
[27] Footnote no. 2 in schedule no. 1, annexed to the VAT Law.
[28] Item (3) of Art. 76(2) of the Executive Regulations (unofficial translation).
[29] Items (1) and (2) of Art. 10 of the VAT Law, and item (1) of Art. 11 of the Executive Regulations.

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## Construction and Engineering Focus Team

The focus team is a constellation of skills in different practice areas with a focus on construction and engineering.

Paolo Daino
*International arbitration, Corporate*

Riccardo Bicciato
*Banking and finance*

Riccardo Bordi
*Corporate*

Paolo Di Giovanni
*International arbitration*

Monica Iacoviello
*Litigation*

Giuseppe Manzo
*Corporate*

Catia Tomasetti
*Banking and finance*

Roberto Flammia
*Banking and finance*

Lorenzo Melchionda
*International arbitration*

Rosaria Longobardi
*Corporate*

Alessandra Rosi
*Administrative law*

Fabiola Rossi
*Tax*

Chiara Mancini
*Litigation*

Giovanni Minuto
*International arbitration*

## Cairo Team

The Cairo Team is a constellation of skills in different practice areas. A selection of members is reported hereunder:

Ziad Bahaa-Eldin
*Banking and finance*

Gianfranco Veneziano
*Corporate*

Riccardo Bicciato
*Banking and finance*

Francesca Secondari
*Corporate*

Mostafa Moussa
*Corporate*

Bahaa Ezzelarab
*International arbitration*

Mohamed H. El Ehwany
*Corporate*

Mostafa Elfar
*Tax*

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