Chapter four

Tax on commercial and industrial activity

Chapter topics:

This chapter will address the tax treatment of the profits of these activities through the following:

First: Conditions for applying the tax.

Second: Determining the profits of commercial and industrial activity.

Third: Taxable Commercial and Industrial Activities

Fourth: Taxable revenues

Fifth: Profits from long-term contracts.

Sixth: Deductible costs.

Seventh: Losses carried forward.

Eighth: Tax Exemptions

Fourth: Taxable Revenues:

- **Net tax profit is determined based on the net accounting profit disclosed in the income statement prepared under the Egyptian accounting standards and in applying the provisions of Law 91 of 2005 and its executive regulations and their amendments.**

- **Article (22) of the Law stipulates that the taxable commercial and industrial net profit is determined based on the gross profit after deducting all costs and expenses needed to realize such profits.**

Fourth: Taxable Revenues:

- From the preceding, it can be deduced that the overall tax profit is computed as follows:

Net accounting profit from the income statement according to Egyptian accounting standards	××
Add:	××
1. Taxable revenues that have not been included.	
1. Nondeductible Costs that have been included.	
Deduct:	(××)
1. Non-taxable revenues that have been included.	
1. Deductible Costs that have not been included.	
Net Tax Profit (Tax Base)	×××

Fourth: Taxable Revenues:

- **Revenues included in the tax base are determined based on the comprehensive concept of revenue resulting from all commercial and industrial operations realized in Egypt, as well as revenues realized abroad if Egypt is a center of commercial and industrial activity of the taxpayer.**
- **In this regard, article (17) of the Law stipulates that Profits from commercial and industrial activity shall be determined based on the revenue resulting from all commercial and industrial operations. This includes profits from the sale of a company’s assets as stipulated in items (1), (2) and (4) of article (25) herein, profits realized from compensation received by a taxpayer because of depreciation or acquisition of any of such assets, as well as the liquidation proceeds realized during the tax period after allowing all deductible costs.**

Fourth: Taxable Revenues:

❑ **The tax treatment of taxable revenues can be discussed as follows:**

(1) Revenue from primary activity:

- **It means the revenues generated from the main commercial and industrial activity for which the establishment was established.**

- **Such revenues are characterized by their periodicity and continuity, as they are derived from production and sales operations in industrial establishments and the purchase and resale of goods in commercial establishments.**

Fourth: Taxable Revenues:

- The profitability model for the main activity varies according to the nature of the activity, but it is ultimately determined by the amount of net sales that exceeds their cost, as follows:

1- Service establishments: It is determined by the difference between the revenues that these establishments earn from providing their services to others and the costs that they incur to provide these services.

2- Commercial establishments: It is calculated by deducting the product's cost from the net sales value.

3- Industrial establishments: It is identified by the difference between the net value of sales and its cost; however, the measurement of the cost of sales differentiates from commercial activity since both the value of production and the change in the value of inventory from finished goods are considered

Fourth: Taxable Revenues:

- There are a set of rules that the tax examiner must observe, which are as follows:

1- Net sales: To verify the actual net sales, it is required to ensure that the sales figure reflects the actual sales that occur during the fiscal year, and the same for the sales returns, by considering the following:

(1) Applying the Accrual Principle: Sales are recorded as soon as the sale has occurred, regardless of the collection of its value.

(2) Verifying that a part of the actual sales has not been deleted and that the sold goods have been delivered to customers

(3) Withdrawals of the establishment's owner: They are recorded at cost, meaning they are not included in sales. If this occurs, the difference between the selling price and the cost must be deducted from the net profit (except for liquidation cases).

Fourth: Taxable Revenues:

(4) Ensure that sales returns are not overvalued due to the omission of the commercial discount previously granted to consumers or the recording of fictitious or unreal returns.

(5) Consignment goods: These goods are sent at invoice price (cost price 100% + profit margin) and are not recorded as sales unless sold. Otherwise, they must be included in the inventory at the end of the fiscal year.

(6) Goods sent to branches: Here, the distinction is made between

- **Internal branches: the goods sent to them are not considered part of the sales unless the branch sells them, and if this does not occur, they are considered part of the inventory.**
- **External branches: the goods delivered to them are included in the sales, regardless of whether the branch sells them.**

Fourth: Taxable Revenues:

(7) Sale of production waste: It is deemed part of the sales, and the resulting revenue is subject to tax.

(8) Barter of goods for in-kind assets: These goods are recorded as sales, and exchange must be made according to the market price or net fair value. If it generates a profit, it is subject to tax, but if it causes a loss, it is regarded as a cost that must be deducted.

Fourth: Taxable Revenues:

2- Cost of sales : In commercial establishments, the cost of sales is computed by adding the value of net purchases (purchases - returns of purchases) to the change in inventory value (goods at the beginning of the period - goods at the end of the period). Thus, the cost of sales can be verified by the following:

a. Net Purchases:

The examiner should consider the following factors:

- Following the accrual basis when recording these expenses.
- Purchase expenses do not include expenses associated with acquiring fixed assets.
- Customs taxes are included in the purchase price when importing from abroad, considering import rules.
- In purchasing inventory on credit, the difference between the on-credit price and the cash price is recorded as interest expense and distributed over the repayment period.

Fourth: Taxable Revenues:

b. Change in inventory:

- **The tax examiner must verify the accuracy of the cost of goods at the beginning of the period and its conformance with what was tax-approved as the end-of-period inventory for the preceding period.**
- **It is also necessary to ensure the accuracy of the inventory at the end of the period and the goods owned by the establishment and has not been disposed of until the date of preparing the financial statements, by considering two significant elements:**
    1. **Quantity:**
    2. **Value:**

Fourth: Taxable Revenues:

(2) Capital Gains from the Sale of the Establishment’s Assets:

- **They are incidental and nonrecurring gains, such as those earned by the establishment from the sale of any of its fixed assets specified in Article (25) of the Law, which include the following:**

- **Clause (1): Buildings, structures, equipment, ships, aircraft.**
- **Clause (2): Purchased intangible assets, including goodwill.**
- **Clause (4): land, works of art, monuments, jewelry and other assets which by nature are not depreciable.**

Fourth: Taxable Revenues:

(2) Capital Gains from the Sale of the Establishment's Assets:

- **Notably, the disposal may involve one of the previously specified assets or total assets of the establishment; in both cases, the realized capital gains are subject to taxation.**
- **Such profits are computed by comparing the net selling price to the asset's net book value after deducting the tax-approved depreciation from the asset's historical cost.**

Fourth: Taxable Revenues:

(3) Profits realized from compensation:

- The taxpayer may receive compensation for depreciation or acquisition of any of such assets mentioned in Article (25) items (1, 2, 4). If the compensation value exceeds the asset's net book value, the difference is taxable income. In the event of compensation, capital gains are determined in the same manner as in the case of the sale of fixed assets.

Fourth: Taxable Revenues:

(4) Profits from the revaluation of the assets and liabilities of the establishment:

- **In this regard, a distinction must be made between three cases that require a re-evaluation of the assets and liabilities of the establishment:**

A. Valuation relative to market prices (identifying the establishment's actual worth):

- The profits from that evaluation are unrealized or estimated profits that are not subject to tax. Since these profits did not result in any real increase in the rights of the sole proprietorship's owner, they are not subject to tax.

Fourth: Taxable Revenues:

B. Altering the establishment legal form:

- The profits from that evaluation are deemed realized profits and are liable to tax due to changing the ownership structure. This is when an establishment offers its net assets as an in-kind share for joining or merging with another company.

C. Valuation to provide the assets as an in-kind share in the capital of a joint stock company:

- Profits from such valuation are not subject to tax to encourage individual establishments to establish joint stock companies, as Article (20) of the Law stipulates that Tax shall not apply to profits from the revaluation of the assets of a sole proprietorship when providing this as an in-kind share to the capital of a joint stock company, providing that the shares corresponding to the in-kind share are nominal and shall not be disposed of within five years.

Fourth: Taxable Revenues:

(5) Realized liquidation proceeds:

- The tax applies to current and capital profits earned during the liquidation period. In this instance, it is indicated that if the liquidation period spans multiple tax periods, the liquidation proceeds are subject to tax during each tax period in which they are realized.

Fourth: Taxable Revenues:

(6) Incidental or non-recurring revenue:

- The revenues generated by the establishment from operations fall beyond the scope of its primary business but are indirectly tied to its assets and properties. Examples include the following:

1) **Investment Income:**

- **Revenues from real estate and farmland:**

- It indicates revenues from renting real estate owned by the establishment to others. Such revenues are subject to tax as long as they result from built real estate or agricultural lands included in the establishment's assets.

Fourth: Taxable Revenues:

- **Dividends for shares and equity quotas:**

- Dividends for stocks and quotas obtained by a natural person residing in Egypt from joint stock companies or partnerships, Except for dividends distributed in the form of free shares, whether these distributions occur in Egypt or abroad.

- **The tax rate on dividends realized from a source inside Egypt during the year received by a resident natural person shall be (10%) without deducting any costs. This price shall be reduced to (5%) if the shareholding percentage in the distributing company exceeds (25%) of the capital or voting rights, provided that the period of possession of shares or quotas is not less than two years, without deducting any costs.**

Fourth: Taxable Revenues:

(6) Incidental or non-recurring revenue:

2) Grants and Subsidies:

- Such as production subsidies and export subsidies that establishments receive from the government and local authority units to help them in production, enable them to compete with foreign goods, or encourage them to provide their services. These grants and subsidies are included in the tax base based on the following:

✓ **Cash grant or subsidy:** It is subject to tax based on what was received during the year.

✓ **In-kind grant or subsidy:** It is liable to tax based on the asset's market or fair value when acquired by the establishment.

Fourth: Taxable Revenues:

3) Compensation and fines:

They are the funds the establishment receives from other parties as compensation for incurred damages, and the following compensation categories can be distinguished:

- **Compensation for losses from non-compliance with contracts or delay in implementation: It is known as fines for breach of contract (penalty clauses) and is subject to taxation.**
- **Compensation for loss or damage to a company's fixed asset and seizure: It is taxable as the capital gains.**
- **Compensation for the loss of current assets such as merchandise: It is deemed revenue for tax purposes and is liable to taxation, even if it was used to replace the damaged current assets.**

Fourth: Taxable Revenues:

4) Collected Bad Debts:

- **These are debts written off in a prior year or years and then collected in the following year. They are taxable if the Tax Authority approved them as deductible costs in the year they were written off, as the last paragraph of Article (28) of the law clarified that if the debt, or part, is collected, the amount collected must be included in the firm's revenues in the year in which the collection took place.**

Fourth: Taxable Revenues:

5) Earned Discount:

- **This discount is considered revenue for the establishment, which it receives from its creditors or suppliers if their debts or obligations are paid before maturity. Therefore, this discount must be included as revenue in the income statement, and it is thus taxable revenue.**

Fourth: Taxable Revenues:

6) Foreign currency differences: A distinction must be made between:

- **Foreign currency differences from foreign currency transactions: These are the differences that result from payment or collection occurring after the transaction date. If such differences are credited, they are regarded as taxable revenues, but if they are debited, they are considered deductible costs.**
- **Foreign currency differences from the translation of the financial statements prepared in a foreign currency: They are considered unrealized differences and are not included in net tax profit (revenue or expense).**

Fourth: Taxable Revenues:

7) Credit Sales Commission:

- It refers to the commission obtained for distributing goods to other companies. It is considered among the taxable revenues, if it relates to sales achieved during the tax year subject to taxation.

Fourth: Taxable Revenues:

8) Credit Returns:

- It includes the returns obtained by the entity as a result of practicing its commercial and industrial activity, such as the proceeds of the sale by installments or the returns of delay on the debts of customers who are late in paying their debts due to the enterprise, or the interest of loans and advances granted by the enterprise. These returns are fully subject to tax.

Fourth: Taxable Revenues:

9) Profits from selling securities:

- They are the capital gains realized from the sole proprietorship's investment of its excess funds in purchasing securities such as stocks, bonds, investment instruments, and financing instruments. These profits are subject to tax as follows:

1- The value of taxable profits is equal to the sale or exchange price or any form of disposal of securities minus the acquisition cost after deducting the brokerage commission (the acquisition cost for free shares is determined by the market value of the share).

Fourth: Taxable Revenues:

2- The tax rate applicable to such taxable capital gains is computed as follows:

- **Capital gains realized in Egypt:**

1- It is subject to a 10% tax rate under two conditions: the taxpayer must be a natural person residing in Egypt, and the securities must be listed on the stock exchange.

2- It is liable to the progressive price if a taxpayer is a natural person residing in Egypt and the securities are not listed on the stock exchange.

Fourth: Taxable Revenues:

2- The tax rate applicable to such taxable capital gains is computed as follows:

- **Capital gains realized abroad:**

- ❑ **It is liable to tax at a progressive rate if the taxpayer resides in Egypt. To prevent double taxation, the foreign tax paid abroad on these capital gains shall be subtracted from the Egyptian tax owed by the taxpayer within the limitations of these profits.**

Fifth: long term contract profits:

- **According to Article (21) of the Law, a long-term contract means a manufacturing, preparation or construction contract, or performance of associated services thereof, carried out by an establishment for other parties based on a fixed value, and the implementation shall take more than one tax period.**

- **Long-term contracts' profitability is measured under Article (21) of the Law and Egyptian Accounting Standard No. (8) as follows:**

- **The taxable net income of an establishment is determined, for all long-term contracts it is engaged in, based on what percentage of each contract is executed during the tax period (completion percentage).**

Fifth: long term contract profits:

- The percentage of the part of each executed contract is determined based on the actual cost of the works implemented until the end of the tax period, which is prorated to the contract's total estimated cost.

$$\text{Completion Percentage} = \frac{\text{Actual costs to date}}{\text{Total estimated costs of contract}} \times 100$$

- The calculated contract profit is determined by the difference between contract values and cost estimates.

Fifth: long term contract profits:

- The contract's estimated profit for each tax period is determined by the percentage of the profit estimated according to the previous paragraph, prorated to that executed during the tax period, provided that the contract profit is adjusted at the end of the tax period in which the contract was completed. Such profit shall be calculated on the actual revenues reduced by the actual costs after deducting the previously estimated profits.
- If the statement of the tax period in which the contract was completed denotes a loss, the loss shall be deducted from the profits of previous tax period(s) when the contract was implemented, providing that the deduction does not exceed the contract profit during the period. The tax must be re-calculated on this basis, and the taxpayer shall recover the excess that had been paid.

Thank you