What is VAT?

Value Added Tax (VAT) is a consumption tax that is levied on goods and services at each stage of the consumer cycle. It is also levied on all goods or services which are imported.

How does VAT operate?

Basic Mechanism

The mechanics of VAT are relatively straightforward. When a business purchases goods or services from a VAT registered supplier, a taxable person, the business will pay VAT input tax on that supply. Similarly, when the business re-sells the goods or provides services, the business will charge VAT output tax to its customer.

VAT registered businesses can usually recover the input tax paid on expenses incurred. This means that VAT should end up being a cost to the business. Rather, the burden of VAT is usually borne by the final consumer for whom there is no recovery mechanism.

Scope of VAT

VAT will be applied within the Gulf Cooperation Council (GCC) region on the following:

- Supply of taxable goods and services by a taxable person.
- The purchase of taxable goods and services by a taxable person who will be obliged to apply the reverse charge mechanism, if the supplier is not taxable person.
- Importing goods from outside the GCC

Recovery of Input Tax

Businesses can only recover input tax when this is paid on taxable supplies. Accordingly, it is anticipated that businesses will be able to recover the full input tax on these taxable supplies. Businesses engaged in exempt supplies, for example, hospitals, may not be in a position to recover the full input tax.

Businesses whose supplies are both taxable and exempt will be required to apportion their input tax recovery accordingly.

Most businesses will usually be in a net VAT payable position, i.e., these businesses will have to forward the difference on the output VAT collected less the input VAT paid to other businesses, to the tax authorities. However, a number of businesses, for example, exporters, may find themselves in a net VAT receivable position, i.e., these business will have incurred higher VAT input paid than VAT output collected. These amounts should be refunded by the tax authorities within a specified period. Within the GCC, the timeline and condition for refunds will be set at a local level.

VAT Rates

The GCC states will levy a standard rate of 5% which will apply to most goods and services, unless a specific relief is provided. There will also be a 0% rate which is expected to apply to essential food items and exported goods and services. These are both taxable rates and give rise to full VAT credit on related expenses.

There will also be certain goods and services which will be specifically “exempt” from VAT, i.e., VAT will not be charged on these goods and services. Any related input VAT will not be eligible for a refund from the tax authorities.

Registering for VAT?

Compulsory Registration

Before businesses can charge or recover VAT, they must register with the local tax authorities.

Businesses with taxable income exceeding the set VAT threshold will be required to register for VAT. The limit will be SAR 375,000 or equivalent.

It is important that businesses monitor the level of taxable income and apply for registration at the earlier of:

- End of a 12-month period where taxable turnover during the previous 12 consecutive months exceeded the threshold; or
- Beginning of any month during which it appears that the taxable income during the month will exceed the threshold if added to the income of previous 11 months.

Voluntary Registration

Business can opt to register on a voluntarily basis where taxable turnover falls between the threshold and 50% of it. This can be useful for the recovery of input tax or maintaining business relationships.

Group Registration

Local legislation in every GCC state will determine whether businesses will have to register as one group or taxpayer or individual taxpayers.

Key industry issues

Financial Services

Financial services are incredibly complex to tax from a VAT perspective. It is not always easy to determine the value-add proportion. Therefore, Financial services are generally exempt from VAT.

Although VAT need not be charged or paid on exempt supplies, these businesses may be required to charge VAT on certain fees and activities. Input VAT incurred in the purchase of exempt supplies is not refundable. However, in certain cases, for example, banks, local law may include a mechanism to recover such input VAT.

Businesses within the Financial services sector should be thinking about recovery options in advance. We expect that the local legislation will include complex partial exemption methods.

Islamic Financial Services

Islamic financial services usually include the supply of goods or services. VAT as it applies to the supply of these goods or services is complex. Unless the local legislation will provide special treatment to these goods or services, customers may refer their business to traditional banks.

Retail and Food

By its definition the retail sector sells directly to the end consumer which will attract its own set of challenges. VAT is borne by the end consumer who will not likely react well to an overnight increase in prices without any prior notice from retailers. Customer retention and pricing strategy will be key areas of consideration. Some retailers may chose to initially absorb a proportion of the VAT cost as a goodwill gesture to their customers.

Certain food items will almost certainly be zero rated, these will largely consist of essential and basic foods.

Education and Healthcare

Both sectors are likely to be exempt from VAT. At this stage it is unknown what the extent of the exemption will be. The exemption is likely to be welcomed by end users, i.e. students and patients. This would mean that healthcare and education costs will not increase. However, the exemption will not be welcomed by the education and health sectors due to the fact that their operating costs will increase.

The exemption will mean that there will be very little VAT recovery, if any, on expenditure. In turn, this will almost certainly increase costs to these businesses which will either be absorbed by the sector, or, passed on to the end consumer.

Property and Construction

It is hard to imagine that the law, when released, will include an array of issues which relate to the land/property and construction sectors. This is an extremely complex sector where the treatment of each supply can change depending on the type of property and type of customer. Special point-of-sale rules are likely to govern where such transactions are taxed. Key issues will be:

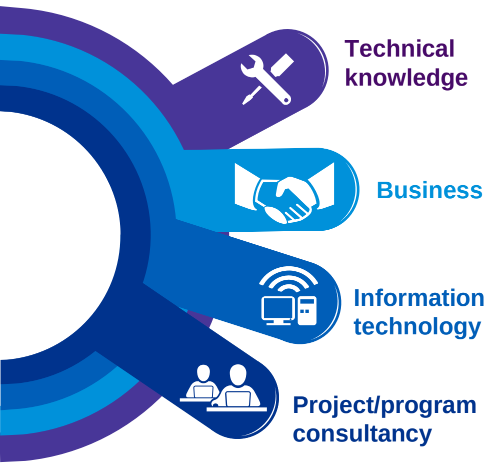
- VAT recovery of mixed supplies.
- Transactions which span the VAT implementation date.
- Prepayments, long-term leases.
- Treatment of non-registered sub-contractors.

What KPMG can offer?

"Global Experience, Local Delivery"

KPMG has the right mix of diverse expertise, experiences and customized methodologies to assist you to achieve a smooth transition into VAT. KPMG has a team of trained experts who have experience in implementation of VAT in different geographies globally. We understand your business and will be able to offer tailor made solutions designed to suit your budget and requirements. Our team of experts are able to guide your staff to prepare for this new tax and ensure that your business is VAT ready and on time with minimal disruption to your business.

KPMG has a multi-disciplinary team with VAT knowledge in:



Our people and experience

KPMG's International Tax Group comprises experienced, international, Middle Eastern and local tax experts with legal, fiscal, and economic backgrounds, as well as experience working in various industries and with tax authorities. By using our KPMG global network we can provide MNEs in the GCC with a global team of tax professionals experienced within VAT. Our network of professionals enables us to apply an integrated approach to your business.

Contact us:

We would be pleased to meet with you to discuss how your company can optimally prepare for this new tax in the Middle East. Please get in touch with your contact at KPMG or with one of our specialists.

- Product/ services pricing
- Legal contracts
- Cash flow management
- Record keeping
- IT systems
- Vendors/ suppliers
- Finance operations
- Governance/ policies

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