KPMG

Value Added Tax Alert

Saudi Arabia increase VAT rate to 15% from 1 July 2020

11 May 2020

The Minister of Finance, His Excellency Mohammed Al Jadaan, announced yesterday that the standard rate of VAT would be increased from 5% to ***15% with effect from 1 July 2020***.

This increase is a response to the unprecedented economic fallout from the impact of the COVID-19 pandemic. Inevitably, the government is seeking to address the fiscal imbalance caused by the dramatic decrease in consumer and commercial spending, the major loss of oil and tax revenues and the cost of the many healthcare initiatives put in place to fight the pandemic. Although there is little detail currently available, we can predict the profound impact that this increase will have on taxpayers and consumers.

Implications for consumers

This increase will impact directly the spending habits of consumers both before and after the rate change – notably, ***the likely spike in spending*** to beat the higher rate of VAT and the subsequent drop in spending after the rate increase. We can expect sales in sectors such as: automotive; retail; electrical; and real estate to increase sharply prior to 1 July, much like the trend experienced towards the end of 2017.

Although VAT is a consumption tax, proportionately, it affects consumers in the middle and lower- income brackets to a greater extent. It is hoped that when additional details are shared, measures will be introduced to soften the impact on all consumers such as lower rates for essential goods and services, for example, basic foods, education and medical services.

Implications for business

Businesses that supply directly to the final consumer will be concerned about remaining competitive and may have to absorb part or all the VAT increase so that the retail prices of goods and services are affected as little as possible. Unfortunately, there may be little choice but to increase prices to cover the additional costs expected to be incurred.

Key issues that will require detailed consideration and action from taxpayers include:

- Supplies that span the effective date of the increase (e.g. rental agreements, insurance contracts, cleaning contracts and subscription services);
- Time of supply (continuous supplies vs one-off supplies);
- Advanced payments received before the rate increase;
- Goods returned after the rate increase;
- Adjustments to VAT clauses in existing contracts;
- Pricing – absorbing the VAT increase to support market competitiveness;
- Annual price lists adjustments;
- Rebate and discounts;
- Purchase of immovable property;
- Changes to accounting systems, point of sale and digital platforms to include the new tax rate;
- Changes to tax invoices, debit and credit notes;
- Change of use of capital assets; and
- Splitting the input VAT apportionment calculation for businesses that make both taxable and exempt supplies.

Businesses in the ***financial and real estate sectors*** where significant proportions of their goods and services are exempt from VAT face a significant increase in costs as they are not able to claim input VAT incurred that relates to exempt activities. This increase will impact profitability and, eventually, will have a cascading effect on customers.

Government bodies, public schools, hospitals are prohibited from claiming any VAT on their expenses because of their activities and so, will be at a major disadvantage from the VAT increase. Also, it will now be vital that foreign businesses that incur VAT in KSA claim a refund from the Government. The deadline for submission of the refund claim for foreign businesses is 30 June for VAT incurred in the previous calendar year.

Along with the rate change comes the increased risk if taxpayers make mistakes in their VAT accounting. It is now more critical than ever to assess the readiness of the business to manage VAT reporting in an accurate and timely manner. The ***VAT penalty regime*** is now extremely concerning in terms of the adverse financial impact that results from accounting errors.

Transitional provisions

Taxpayers must review existing contracts that provide for ongoing or periodic supplies of goods/services. For example, for continuous supplies (e.g. services, construction or installation of complex equipment), it would be prudent to agree an intermediary service acceptance and invoicing protocol to avoid the entire supply being taxed at the higher rate especially in situations where customers are unable to recover input VAT in full. In this respect, the businesses should analyze the transitional rules which are expected to be issued and take respective measures.

Implications for the GCC

The impact on the GCC Agreement and the future of VAT in the region is unknown. As per the Agreement, the VAT rate is stipulated as per Article 25 and is not determined by local law or regulations. Such an increase should be agreed amongst the member states and announced at least 6 months before implementation, so that business and consumers can plan. As of today, the VAT increase in Saudi Arabia is 6 weeks away.

Undoubtedly, questions will be raised regarding the enforcement of the GCC Agreement as a common VAT framework - will the remaining GCC countries also increase their VAT rates to match Saudi Arabia? If the rates across the GCC are not aligned, consumption and spending in the Kingdom is likely to shift to those GCC states without VAT or with lower VAT rates.

How KPMG can help you?

There remain many unanswered questions as a result of the prospective VAT rate increase. Whilst we expect more details to be provided in the coming days and weeks, given the short timeline until the rate change, businesses must act urgently to assess the consequences for their operations and plan to make the necessary changes.

We at KPMG would be pleased to offer our support to help you prepare for the imminent changes to the Saudi VAT regime. Please feel free to connect with our team members.

Contact us

Nick Soverall
Head of Indirect Tax, KSA
T: +966 583 401111
E: nsoverall@kpmg.com

Oleg Shmal
Director, Riyadh
T: +966 50 239 2023
E: oshmal@kpmg.com

Amine Mechalikh
Director, Jeddah
T: +966 56 864 0506
E: amechalikh1@kpmg.com

Anil Bahl
Director, Khobar
T: +966 55 719 4636
E:anilbahl@kpmg.com

kpmg.com/sa