



Gulf Cooperation Council states gear up for VAT in 2018

Will you be ready?

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The member states of the Gulf Cooperation Council (GCC) have developed a broad framework for the introduction of value added tax (VAT) across the GCC on 1 January 2018. A unified framework agreement — which appears to have been signed by each state and is expected to be made public soon — sets out the underlying principles of VAT laws for the six GCC countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates (UAE). Following the framework's release, each member state will issue VAT legislation.

The new VAT will affect nearly every GCC business in some way — and a 1 January 2018 start date leaves only a short window for businesses to prepare. In this article, you'll find out how the tax is likely to apply and what businesses with operations in the GCC should be doing now and in the coming months to get ready.



Adopting VAT aims to diversify revenue and ease dependence on oil

The GCC countries have been compelled to adopt VAT to cultivate more reliable and diverse sources of revenue and to reduce their dependence on oil and other hydrocarbons. According to the International Monetary Fund (IMF), the recent plunge in oil prices caused oil-exporting countries in the Middle East and North Africa to lose over 340 billion US dollars (USD) in oil revenues from their budgets in 2015 — representing 20 percent of their combined gross domestic product.¹

In a region that has not relied historically on tax revenue, the introduction of VAT stands to transform the GCC's economy.

In February 2016, the IMF said that by putting in place a simple VAT system, even at a low single-digit rate, GCC countries could raise up to 2 percent of their GDP. The GCC group's decision to coordinate their VAT implementation is in step with their longstanding economic agreement and customs union. The UAE Ministry of Finance points out that the GCC countries have a history of cooperating in the design and roll-out of public policies, recognizing that collaborative approaches are better for the region.²

Implementation on track?

Delays in the public release of the signed unified VAT framework have cast some doubt on the date of implementation. Although it's possible that implementation could be either postponed or staggered, with the VAT taking effect in different countries on different dates. Recent indications point toward a common implementation date. GCC members probably would want to prevent potential

VAT avoidance by businesses and consumers taking advantage of the VAT-free status of GCC states that fall behind in their implementation. Until any delay is officially announced, the date for VAT implementation across the GCC remains at 1 January 2018.



¹ Speech by Christine Lagarde, Managing Director, IMF, 22 February 2016 (<https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp022216>, accessed 21 December 2016).

² UAE Ministry of Finance website (<https://www.mof.gov.ae/En/budget/Pages/VATQuestions.aspx>, accessed 21 December 2016).

Common VAT based on EU and OECD models — with local differences

The common GCC VAT is expected to be modelled on the VAT currently in place in the 28 member states of the European Union (EU). The VAT framework will set out the overarching regulations governing intra-GCC and international trade. These are likely to be broadly in line with the international VAT guidelines of the Organisation for Economic Co-operation and Development (OECD).

Additionally, each country will develop domestic legislation governing the treatment of local supplies and the administration of VAT internally. As with most VAT systems, there will be a degree of flexibility from state to state for the VAT treatment of specific items. The markets and economies of each state will shape these variations.

Where a state aims to promote trade in a certain sector, such as the automotive sector, they may opt to ease the

VAT impact. For example, the UAE's free zone is a large contributor to the country's business infrastructure and has attracted significant foreign trade due to its tax-free status. Any negative VAT impact could see businesses and foreign trade relocated to other free zones, so the UAE might apply a VAT-free status to the zone to preserve its appeal.

Based on international practice, most VAT regimes treat commercial property and first sale of residential as taxable but the leasing of residential and subsequent sale as exempt. Financial services where consideration is margin-based are often treated as exempt while fee-based services tend to be taxed. In similar vein, the international transport of passengers and goods is typically zero-rated, as are some basic foods and medicines. Whether the GCC VAT will adopt such treatment remains to be seen.

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Will flexibility breed complexity?

Despite the level of consistency that the unified VAT framework will bring, the discretion on how certain goods and services are treated will create variations in the VAT rules among the GCC states, especially for domestic transactions.

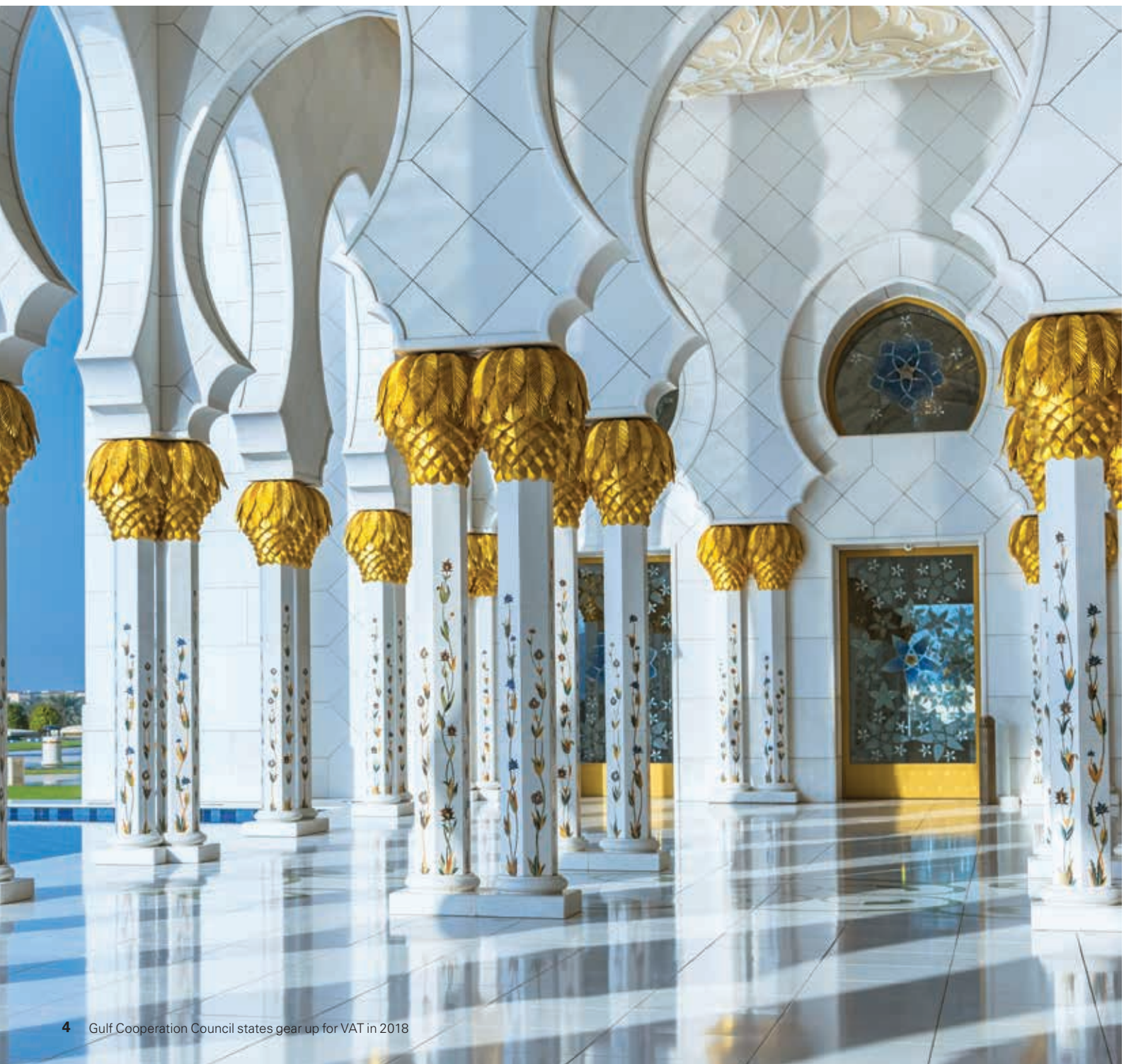
Businesses that are familiar with trading with the EU will be accustomed to the resultant complexities in complying with these differences and ensuring their business operations are set up to be VAT-efficient.



How are the tax authorities responding?

The tax authorities in the region are gearing up for the VAT by actively recruiting resources and setting up processes to manage and support VAT administration. KPMG in Saudi Arabia reports that the country's General Authority of Zakat and Tax (GAZT) is developing an online portal for the submission of VAT returns.

VAT will be a new concept for GCC businesses and tax authorities alike, and both sides are likely to require some guidance on managing and administering the new requirements. Tax advisors with experience advising companies and governments in other VAT-levying jurisdictions are well suited to act as intermediaries to ensure a smooth transition.



The new GCC VAT: frequently asked questions

While detailed legislation is not yet available and the GCC countries have some scope to tailor the rules to suit their own goals, it currently appears that the GCC VAT systems would have the following broad characteristics.

Which businesses would need to register?

- Businesses selling goods or delivering services that are VAT-able are generally required to register for and collect VAT.
- Exemptions may be allowed for some businesses, such as pharmaceutical and educational companies, banks and life insurers, and businesses involved in the sale or lease of property.

What standard rate will apply?

- The standard VAT rate in each GCC member state is expected to be 5 percent for standard-rated supplies.
- Most local supplies of goods and services in a country are generally included in this category, including:
 - wholesale and retail sales
 - food consumed in a restaurant
 - services provided by legal and accounting firms.

Will reduced rates apply to selected goods and services?

- Some goods and services could be subject to VAT at a rate of 0 percent ('zero-rated supplies').
- Other goods and services could be exempted from VAT altogether ('VAT-exempt supplies').

How is the VAT expected to operate?

- VAT-registered businesses would charge and collect VAT on the supply of VAT-able goods and services ('output VAT').
- Businesses usually would be entitled to a refund for any VAT paid on VAT-able goods and services procured by the business ('input VAT').
- The business would then remit net VAT — output VAT less input VAT — to the tax authority.

How is the VAT expected to apply to imports?

- Goods and services imported into a country are generally subject to VAT at the time of import.
- VAT in relation to such goods is often collected by the customs authority at the time of release of the shipment. VAT on imported goods generally applies on landed cost, inclusive of any customs duty.

How is the VAT expected to apply to exports?

- Goods and services exported out of a country may be zero-rated, that is, are subject to VAT at a rate of 0 percent.

Are any supplies out of scope?

- Supplies where goods and services are delivered by an overseas supplier to another overseas person are generally included in this category.
- Private and non-business transactions generally are also out of scope.

What VAT reporting and payment obligations are expected?

- VAT-registered businesses must submit periodic returns to their respective tax authority monthly, quarterly, bi-annually or even annually, depending on the magnitude of the input and output VAT amounts.
- The VAT returns will summarize different categories of VAT-able supplies subject to output and input VAT and the net amount to be paid or claimed as a refund, or carried forward to be claimed against a future VAT liability.

How could VAT affect your business?

Based on the experience of KPMG member firms with the implementation of significant indirect tax reforms in other regions, it is crucial for businesses to start preparing for the VAT now. VAT implementation is likely to have a significant impact across the company's operations:

- **Business processes:** The reforms will affect order-to-cash, procure-to-pay and record to report processes, requiring new forms (invoices) and new reports to facilitate the completion of VAT returns.
- **Accounting and IT systems:** Complying with VAT may require reconfiguration of IT systems, changes to vendor and customer master data, tax condition logic updates, and new tax code/GL accounts.
- **Supply chains:** Cash costs may arise if the company's supply chain is not structured efficiently, and indirect tax costs may arise if the wrong party acts as importer of record.
- **Contracts:** Contracts may need to be reviewed to help ensure compatibility with VAT, and clauses on, for example, tax, pricing and changes in law may need to be changed or added.
- **Pricing:** The pricing of products and services may need to be reviewed. In cases where customers cannot recover the tax charged, suppliers may need to consider absorbing some of the tax cost.
- **Treasury:** Cash flow forecasts may need to be updated, and company cash flows may change due to VAT credits.
- **Human resources:** VAT may apply to amounts paid to employees, such as fringe benefits, gifts, allowances and expense claims. Companies also need to ensure they have sufficient resources (e.g. accountants and tax advisers) to manage their new obligations.

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Getting ready for VAT: four steps to a smooth transition

Even though the VAT rules are not yet available, there are steps you can take to smooth the transition and manage the changes to come. By undertaking the first steps in the process now, you will be ready to implement your VAT compliance solution once detailed legislation is released.

- 1. Plan and analyze** — Review your business operations to identify areas where changes may be needed to your company's operating policies and procedures and accounting, ERP and systems in order to meet compliance requirements. Your organization also stands to benefit from an in-depth nexus studies, supply chain analysis and taxability review.
- 2. Assess impacts** — Designing the changes needed to policies and procedures and the accounting, ERP, systems and preparing a roadmap for required changes to be made with minimal disruption to the client's business.
- 3. Implement** — When the details of the VAT are known, you can then begin to flesh out and implement your VAT plan. The stage involves testing your IT and VAT compliance reporting systems, training staff, pursuing VAT registrations and reviewing the potential benefits of special VAT schemes (e.g., forming a VAT group).

- 4. Go live!** — Once the VAT is in place from 1 January 2018, systems will require detailed testing and monitoring to ensure their effectiveness and accuracy, resolve teething issues and refine compliance practices.

For any business, cash is king. Neglecting to prepare for VAT could impede cash flows and restrict the business's ability to continue trade as usual. More importantly, businesses could lose visibility over their VAT expenditure, causing VAT leakage where VAT is not being fully recovered and reducing profits on the bottom line.

Based on the experience of VAT professionals with KPMG International's member firms, poor VAT management can cause businesses to lose up to 30 percent of their recoverable VAT costs. Where businesses operate on tight margin, or for businesses who will be making exempt supplies, it is essential this is managed efficiently and effectively.

By taking steps to prepare your business for GCC VAT compliance now, you can help ensure that you maximize VAT recovery on your business inputs, reduce adverse cash flow implications, ensure timely compliance with VAT obligations and reporting, and mitigate any risk of fines, penalties and reputational damage.

How KPMG firms can help

KPMG tax professionals in the GCC and worldwide have the necessary competence and experience to assist businesses and organizations in preparing for the VAT implementation from a consulting, compliance and technology standpoint.

Our indirect tax professionals are able to assist clients with questions relating to the upcoming changes, including nexus studies, taxability reviews, supply chain analysis and review of compliance requirements.

Our compliance centers will be able to assist clients with the preparation and filing of VAT returns.

Our management consulting professionals will assist clients in the implementation of automated solutions to their transaction tax compliance process.



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