INDIRECT TAX

GCC VAT

Key insights including Free Zones

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BDO

The GCC Unified Agreement for VAT

GCC UNIFIED AGREEMENT FOR VAT

THE UNIFIED AGREEMENT FOR VAT (“UA VAT” or “the Agreement”) IS A MAJOR STEP TOWARDS IMPLEMENTATION OF VAT IN THE GCC

THE UA VAT CONTENTS HAVE STARTED TO CIRCULATE AND THE QUESTION IS:

WHAT DOES THE DRAFT AGREEMENT SIGNPOST FOR THOSE WHO DO BUSINESS IN AND WITH THE GCC?

UNIFIED AGREEMENT FOR VAT

1 January 2018
Rate 5%

What is the purpose of the UA VAT

The UAVAT sets out a broad framework for the tax. It's a structure that provides for a consistent and coordinated approach across the region, which is designed to reduce the risk of VAT creating any distortion of competition between member states. It is not unnecessarily restrictive however, and allows member states a measure of flexibility in the way the tax is applied.

This big picture approach to VAT demonstrates the desire of the member states to bring long-term consistency to their economies and builds confidence in the business sector.

It is being used to manage investment in economic innovation and value addition with an aim of creating sustainable economic growth.

The UA VAT introduces VAT at a rate of 5% and allows member states some discretion on how they apply the VAT laws and the scope of exemptions and reliefs.

For example, the UAE has indicated the exemptions it will apply will include Space, Technology and Renewable Energy; a significant boost for businesses working in those industries.

Scope of VAT in the GCC

Under the Agreement, VAT applies to the following :

a) Taxable supplies by VAT registered persons (individuals, partnerships or companies).

b) The receipt of goods or services by a VAT-registered person from outside the member state (in this case the reverse charge mechanism applies).

c) Importations of goods by any person.

Cross-border sales - what are we expecting?

INSIGHT

The Agreement is heavily based on the European VAT model.

This may be helpful. It is a well developed model and the principles will be familiar to anyone who has had exposure to the EU VAT system.

Looking at the Principles in European law gives an insight into the way VAT will work on a day to day basis in the GCC.

REVERSE CHARGE

- The reverse charge ensures VAT is paid in the buyer's country.
- It ensures the buyer can gain no advantage by buying from a foreign supplier
- For most businesses it is a paper exercise with no VAT cost.
- For a business that cannot claim all of its VAT – for example a businesses that makes exempt supplies – the reverse charge will ete a 'real' cost.

Cross border sales and purchases

Goods

- When goods are imported from outside the GCC, VAT will be payable when they enter the country (or are released from bond if they enter a customs-free area).

- Exports from a GCC member state to outside GCC region will be zero-rated (VAT-free).

- For sales between GCC member states the sale will be zero-rated but the buyer will not pay VAT at import. Instead, the buyer will 'self account' for VAT using a 'reverse charge' process.

- The reverse charge requires the buyer - not the seller - to enter an amount of VAT on its VAT return as if it has sold the goods itself . On the same return the buyer claims the VAT as a deduction. The net result is a nil VAT impact **provided the buyer is entitled to reclaim all of its VAT.**

Services

- The general rule is that cross border services delivered on a business to business basis are taxed using the reverse charge .

- If a business sells services to a buyer in another member state, no VAT is charged and the buyer accounts for a reverse charge.

- If services are bought from outside the GCC, again a reverse charge is triggered.

- The exceptions to this general rule are likely to include real-estate services, telecommunications, admission to events, restaurants and hotels.

- With these exceptions, the rules will vary for each type of service and for example, in the case of real estate, it will be taxed according to where the real estate is located – not where the customer is located.

Exemptions - what are we expecting?

INSIGHT

The Agreement provides a broad range of potential zero-rates and exemptions.

Each member state will be able to tailor them as it sees fit.

There might be some important differences from country to country, driven by local priorities.

Exemptions and Zero-rating

Zero-rating will be possible for the following:

- The oil and gas sector
- Medicines and medical equipment
- International and intra-GCC transport and related services
- Exports of goods to outside the GCC
- Supply of investment gold, silver and platinum
- Certain food items.
- Supply of maritime, air, land transportation
- Supply of rescue planes, rescue ships, assistance at air and sea, and ships designated for fishing

Member states have a choice of exemption or zero-rating for the following sectors:

- Education
- Medical
- Real Estate
- Local transport

ZERO RATE

- No VAT is charged
- The supplier can reclaim all of the VAT on its costs.
- Result: complete relief from VAT

EXEMPTION

- No VAT charged
- The supplier cannot reclaim VAT on costs linked to the supply.
- Result, partial relief from VAT – the customer may benefit from a slightly lower price but the supplier has an additional cost.

- Financial services are exempt from VAT under The Agreement , however each member state will have some discretion on how this is applied.

- Financial institutions maybe able to claim VAT refunds of some of the VAT they incur based on a refund ratio, which will be set by each member state.

- The insurance sector is not specifically mentioned in the Agreement. However some types of insurance may benefit from the exemptions in the financial services sector.

VAT compliance – what are we expecting

INSIGHT

Below are some highlights of the compliance requirements under the Agreement

- Entities with an annual turnover of USD 100,000 or more will be required to register for VAT
- Entities with annual turnover of USD 50,000 to USD 100,000 will have the option to register for VAT.
- Broadly, for the purpose of working out the VAT registration threshold, annual turnover is computed as follows:
- Total annual turnover less exempted supplies, earned in the last twelve months; or
- Total annual turnover less exempted supplies, that is expected to be earned in the next twelve months
- Tax invoices and accounting books: records must be kept for a period not less than five years. Such documents should be kept for a period of fifteen years if they relate to real estate.
- VAT grouping of two or more legal persons resident in the same member state is permitted.
- Each member state is to determine the length of VAT filing periods, provided that it is not less than one month period.
- VAT registered persons in one member state can claim a refund of VAT paid in another member state.

KEY DEFINITIONS

Supply: any form of supply of goods and services for consideration

Supply of goods: transfer of ownership of physical property including water and all types of energy, financial leasing and real estate transactions.

Taxable person: an individual, company or partnership that carries on an economic activity and is registered for VAT

Economic activity: An activity being practiced continuously and regularly, including commercial, industrial, agricultural, professional, service activities, or any usage of material and non-material property and any similar activity.

VAT Group: Two or more companies treated as a single taxable person

Free zones - what are we expecting?

THE VAT TREATMENT OF FREE-ZONES IS A HOT TOPIC.
THE TREATMENT OF FREE ZONES IN EUROPE AND ALSO MALAYSIA, WHICH INTRODUCED VAT IN 2015, MAY GIVE SOME INDICATIONS OF WHAT WILL HAPPEN BUT A RANGE OF OUTCOMES IS POSSIBLE

Free zones

The Agreement does not lay down any rules for the VAT treatment of supplies between free zones and other areas. This is something that will be down to member states to decide on.

It is expected that duty-free goods in bonded areas will remain VAT-free until they are removed from bond and that any sales of the goods prior to the point where they become duty paid will be VAT-free.

This would be in line with the current customs duty treatment for the goods. It would also be consistent with most bonded facilities in Europe, China and with the approach Malaysia took for sales in bond when it introduced VAT. In Europe, Luxembourg Freeport is an example of a storage and trading platform where goods can be stored, serviced and traded VAT and customs free. Goods are only subject to VAT when they are removed from the Freeport. The facility only provides benefits in relation to physical goods, however. It does not provide any special status for companies.

The status of companies in the GCC free-zones, when they buy and sell goods and services in the normal course of their business (ie other than dealing with goods in bond) is not yet confirmed. It is common in other VAT regimes for goods handling and transport services to be VAT-free but there is some logic in assuming that any other supplies bought or sold will be liable to VAT in the same way as they would for any non free-zone business.

There have been precedents from elsewhere in the world that show there are a range of options . In some cases companies in free zones have been given a status that gives them relief from VAT and it is not out of the question that GCC free-zone companies could receive some beneficial VAT treatment. The Shannon Free Zone in Ireland allowed businesses registered in the free-zone to have goods supplied to them zero rated by quoting their registration numbers and declaring that they were trading within the free zone. It also allowed VAT-free trading between companies provided both were registered in the free-zone.

Examples such as Shannon demonstrate that broad VAT reliefs for free zones are possible. However, this would require the national law to specifically exclude the free-zones from VAT . Ultimately, it may not be practical to provide total relief from VAT because of potential distortions of competition and the risk of undermining the tax base.

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Whilst more than 150 countries have implemented VAT or Sales Tax, BDO has found that many businesses fail to take account of VAT in some business arrangements – for example in real estate deals. BDO can help you identify business transactions where VAT has an impact.

What should businesses be doing now?

Although the final details of the law are not yet available, it is important that businesses take action now as preparing for the impact of VAT needs to be carefully planned and there is much that can be done, even before the release of the final law.

Business will need to consider the following:

- Assessing the key areas that will be impacted by VAT;
- Assessing the existing IT system's ability to handle VAT;
- Understanding and modeling how VAT may impact the profitability and cash flows of the business;
- Reviewing current contracts to determine if VAT has been addressed;
- Identifying intra-GCC transactions and intra-company transactions;
- Creating a change management plan and training staff;
- Communicating with suppliers and customers;
- Ensuring that appropriate books of accounts and records are maintained;
- Preparing a VAT implementation plan and roadmap; and
- Identifying a project team to manage implementation.

VAT is likely to have implications across the whole business, with considerations for the finance department, IT, HR, sales and marketing and legal.

A phased approach is required to deal with the potential issues, starting with an initial impact assessment to establish the key VAT touch points for the business.

After this initial stage it will be possible to build a plan for implementing the changes that will be required, including the essential changes to IT systems and accounting processes.

There is a limited time span left for businesses to get ready

BDO can help you

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