VALUE ADDED TAX

INSIGHTS INTO THE VAT LAW AND REGULATIONS OF SAUDI ARABIA

Saudi Arabia General Authority of Zakat and Tax ("GAZT", or "the Authority") has on 26 August 2017 released the final version of its implementing regulations of Value Added Tax ("VAT") law. This comes after Saudi Arabia issued its VAT Law on 28 July 2017 ("the VAT Law"). Saudi Arabia is the first country in the Gulf Corporation Council ("GCC") to have issued its VAT law and regulations.

VAT is an initiative agreed upon by GCC member states (comprising Saudi Arabia, Kuwait, United Arab Emirates, Oman, Bahrain and Qatar) to help improve the budgets of the states in view of the drop in oil prices. The VAT regulations issued by the Kingdom of Saudi Arabia ("the VAT regulations) consists of twelve chapters covering the following:

1. Definitions
2. Taxable persons
3. Supplies of goods and services
4. Place of supply
5. Exempt supplies
6. Zero rated supplies
7. Value of taxable supplies
8. Imports
9. Calculation of tax payable
10. Procedures and administration
11. Refunds
12. General provisions

Below is a summary of the key highlights of the Saudi VAT regulations:

Taxable Persons

Taxable Person in the Kingdom of Saudi Arabia ("KSA") is defined to mean a person who conducts an economic activity independently for generating income, and is registered for VAT, or required to register for VAT in KSA.

Scope of VAT

VAT in KSA applies to the following transactions:

a) Supply of goods or services in KSA by Taxable Persons with turnover that exceed the mandatory registration threshold, except those providing exempt supplies or services.
b) Importation of goods into KSA.
c) Imported services to customers in KSA.

Registration

KSA has decided to implement VAT into two phases to allow more time for small sized businesses to get ready for VAT by reducing the mandatory registration threshold in the first year of VAT implementation. VAT registeration will be implemented into the following phases:

a) Phase 1: Businesses with a turnover exceeding 1,000,000 SAR per annum must get registered for VAT by 1 January 2018. The deadline for registration is 20 December 2017. Businesses with a turnover between 375,000 and 1,000,000 SAR can register voluntarily.

b) Phase 2: from 1 January 2019 businesses with a turnover that exceeds the mandatory registration threshold of 375,000 SAR must get registered for VAT. The deadline for registration of "phase 2" is 20 December 2018. The voluntary threshold for registration remains at SAR 187,500.

There is a requirement for Taxable Person to carry out an estimate of annual turnover for the year 2018 to determine whether such person would be required to register for VAT.

Entities that are not required to register for VAT by 1 January 2019 have a requirement to register within 30 days from the date their turnover exceeds 375,000 SAR. This requires small sized businesses to regularly monitor their turnover.

VAT grouping

VAT grouping will be permitted and will allow 2 or more companies in KSA that are under common control to be covered by a single VAT registration. Supplies between the VAT group members will not be subject to VAT. VAT group members will be jointly and severally liable for VAT debts.

There is requirement for a minimum ownership or control of voting rights of 50% or more. This allows entities with equal partners holding a 50% share ownership to utilize VAT group registration and compliance.

VAT Returns & Payments

- Businesses with a turnover below 40 million SAR are required to submit VAT returns on a three month cycle (not necessarily calendar quarterly).
- Businesses with a turnover above 40 million SAR are required to file VAT returns monthly.
- VAT payment needs to be made by the last day of the month following the VAT period followed by the taxpayer.

Payment basis Vs invoice basis

Businesses can account for VAT using the payment basis (where VAT is accounted for based on payment received / made) or on invoice basis (where VAT is accounted for based on invoices received / issued). Subject to the approval of the Authority, companies are permitted to account for VAT using the payment basis (instead of the standard invoice basis) provided that the annual supplies of the company does not exceed 5 million SAR in the past calendar year and the anticipated value of supplies for the current year does not exceed such threshold. Entities with annual turnover above 5 million SAR will be required to use the invoice basis for accounting for VAT.

For companies that are approved to use the payment basis approach, in the event that taxable supplies exceeds 5 million SAR at any point of time, must submit an application with the Authority requesting a change from payment basis to invoice basis.

Exempted supplies

KSA VAT law and regulations have exempted very limited supplies as summarized below:

1) Supplies of financial services are exempt from VAT except in cases where the consideration is payable by way of an explicit fee, commission or commercial discount.
2) Life Insurance; and
3) Leasing or licensing of residential real estate.

Zero rated supplies

1) Exports of goods outside the GCC
2) Medicines and medical equipment
3) International transport and related services
4) Investment gold, silver and platinum
5) Some international services. Broadly, supplies of services (except for services connected to land and buildings, or to the country of performance) to recipients not established in the GCC will be zero-rated, provided certain conditions are met. The supply of services (with a few exceptions including land related services, cultural, entertainment and sporting services) to businesses in the GCC will also be VAT-free. For intra - GCC supplies the recipients are expected to reverse charge local VAT. See below for an explanation of the reverse charge.

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 additional cost.

Imports

- VAT is payable on the import of goods into KSA regardless of their origin. The business may then deduct this VAT as input tax, subject to the normal rules for VAT recovery.
- Once the GCC states implement the planned GCC VAT Integrated System, import from GCC states will not be subject to VAT in KSA - instead the importer in KSA can apply the reverse charge mechanism provided certain conditions are met. Until then, VAT must be paid by the importer on imports into KSA from other GCC states.
- The basic rule is that the VAT is payable at the time of import. However, taxpayers will be able to apply for permission to defer payment of the VAT so that it is paid (and at the same time claimed) on the VAT return. This would remove the negative cash-flow impact of paying VAT at the time of import.

Exports

- Export of goods from KSA to a buyer outside the GCC will be zero-rated.
- Before the GCC states implement the planned GCC VAT Integrated System, supplies of goods involving transport from KSA to another GCC state will also be zero-rated.
- After the GCC states implement the planned GCC VAT Integrated System, Exports to VAT-registered customers in other GCC states will be VAT-free, but only if the customer can provide a VAT identification number issued by its home state.
- Exports to persons unregistered for VAT in the other GCC states will be "VAT-able", and will be subject to VAT in the country of supplier if total supplies in the receiving GCC state are below the mandatory threshold. If total supplies exceed the threshold, VAT becomes payable in the receiving member state and the supplier has to register for VAT there.

Financial Services

Income relating to certain financial services such as interest, lending fees charged with implicit margin on loans, credit cards, mortgages, financial leases and murabaha arrangements will be treated as exempt supplies. Brokerage services commissions charged on an implicit margin will also be exempt from VAT.

Fees from financial services such as general accounts administration (e.g. current and savings accounts), money transfer, cheque issuance fees and explicit asset management fees are expected to be subject to VAT at the standard rate.

Entities in the financial sector will most likely have a mixture of exempt and taxable supplies which creates complexity for input tax apportionment and recovery.

Real Estate

While the leasing of residential real estate is exempt from VAT, the sale of residential real estates is subject to VAT at the standard rate. The only exception to that is the sale of a real estate that was occupied by the seller himself, or by a close (4th degree) relative of the seller, in which case the sale would be exempt.

The leasing and sale of commercial real estate is subject to VAT. This captures hotels, guest houses, motels, serviced accommodation or any building that offers temporary accommodation to visitors (e.g. chalets).

With respect to real estate services, the place of supply is usually where the real estate is. For example, services provided by estate agents or architects inside KSA relating to real estate in Oman will be deemed to have been supplied outside KSA so no VAT will be chargeable, even if the client is a KSA resident.

Telecommunication & electronic services ("TES")

Broadly, the place supply of TES is the location where the customer is required to be present to use and enjoy such services (eg a phone kiosk). In all other cases, the location of the supplies becomes the place of residence of the customer.

Non-residents

Non-resident persons required to pay tax on supplies made in KSA are required to register for VAT within 30 days of the first supply on which such persons are obliged to pay VAT.

Non-resident persons not registered for VAT that make taxable supplies to individuals or entities resident in KSA that are not VAT-registered, must appoint a local representative in KSA to register and account for VAT. The VAT representative will be jointly liable for the VAT obligations of the appointed non-resident person.

Reverse-charge mechanism

The reverse charge mechanism ensures that a business cannot avoid VAT by buying goods or service outside KSA. Very broadly, if a KSA business buys services from outside the kingdom it must treat the supply as if it was made to and by itself. This creates an obligation for the supplier to declare output (sales VAT) on its VAT return. On the same return the business will claim deduction for the VAT as input tax. For a business that claims all of it's input tax the reverse charge is simply a paper entry which creates no liability. However, of the business cannot claim all of its VAT (such as a bank) the reverse charge creates a 'real' cost.

Bad debts

Companies can reduce prior output tax paid on consideration not received from a customer, provided certain conditions are met. For bad debt that exceeds 100,000 SAR, taxable person must maintain proof that legal action was taken without success, such as a court order.

Used goods

Taxable Persons registered for VAT selling certain used goods ("Eligible Used Goods") can use the margin method to calculate the VAT payable, provided certain conditions are met and after obtaining approval from the Authority to use such method. The used goods must be in KSA and have been specified by the Authority as Eligible Used Goods. Broadly, under the profit margin method, VAT is payable on the profit made on the supply of the used good (i.e. that profit is reported as a sale amount).

Vouchers

The supply of vouchers will not trigger a VAT liability however a supply will be deemed to have been made when the voucher is redeemed.

Gifts & samples

Gifts and samples distributed without consideration for promotion purposes, or provided to the employees, are not considered as "deemed supply" and therefore not subject to VAT, provided that the market value does not exceed 200 SAR VAT Exclusive to each recipient per year. The maximum annual value of such supplies of gifts and samples that can be made without consideration is 50,000 SAR based on market value of such supplies

Effect of VAT on consumers

Consumers will face increased cost from 1 January 2018. It is worth noting that food, medical and education services (at least private), and local transport will be subject to VAT. Accordingly, consumers will witness increases in cost.

Government bodies

Government bodies acting in their capacity as A public authority will be outside the scope of VAT and are not required to register for VAT. However, government bodies or their entities that provide supplies of goods or services outside their capacity as public authority will be treated as carrying out taxable activities and therefore are required to register for VAT. We understand that government bodies offering public services such as schooling or medical services will not be required to register for VAT. If this is correct any charges for such services will be VAT-free.

Transitional rules

- Provided certain conditions are met, long term contracts silent on VAT, entered into prior to 31 May 2017, are allowed to be treated as zero-rated (no VAT is charged on the supply but the supplier can claim input tax on eligible costs) until the earlier of: (a) expiry of the contract, (b) renewal of the contract, or 31 December 2018 provided that the customer is entitled to deduct input tax on such supply.

- As mentioned above, businesses with annual turnover of below 1 million SAR will not be required to register for VAT until 1 January 2019.

- Invoices issued, or payment received, before 1 January 2018 for a supply which takes place after 1 January 2018 will be deemed to be a supply subject to VAT. For supply of goods, the date of supply will be the date when the goods were delivered or made available to the customer. In the case of services, the date of supply will be the date the service was completed.

Tax invoices

Tax invoices must be issued for all sales of goods and services to VAT registered customers. The VAT invoice must include the following details in Arabic, in addition to any other language used on the invoice:

- Date of issue;
- Identifying number of the invoice;
- Supplier's VAT number;
- Where the customer has to 'self-account', a statement to that effect and the customer's VAT number;
- Name and address of customer and supplier;
- Detailed description of goods or services and quantity supplied;
- Price, rebates and discounts;
- Rate of VAT and VAT payable;
- Details of any special scheme used (e.g. profit margin scheme for Eligible Used Goods)

Simplified invoices are permitted to be issued for a supply below 1,000 SAR provided such invoices contain the following

- Date of issue
- Name and address of supplier
- Supplier's VAT number
- description of goods or services supplied
- Amount payable for the goods or services supplied
- Amount of VAT payable or a statement showing that the amount payable is VAT inclusive.

There appears to be no specific requirements to issue hard copy invoices as per the final VAT regulations. The draft VAT regulations required hard copy invoices to be issued.

Penalties

- Late registration penalty – 10,000 SAR
- VAT return errors – up to 50% of the error
- Failure to pay tax to the Authority on time: 1,000 SAR plus 5%, 10%, 20% or 25% of the tax due depending on how late the payment is.
- Incorrect issue of invoices: the higher of 1,000 SAR or double the tax
- Failure to comply with various regulations: 1,000 SAR or 2% of monthly taxable supplies, up to a maximum of 20,000 SAR
- Making false statements: double the tax involved
- Tax Avoidance: Double the tax plus a penalty by the Administrative Court
- Penalty for Tax Officials committing breaches of confidentiality: up to 1,000,000 SAR plus up to 2 years imprisonment.

Advance ruling:

It is possible for businesses to obtain advance rulings from the Authority where necessary to clarify the provisions of the VAT law and regulations.

FOR ADVICE ON HOW BDO CAN ASSIST PLEASE CONTACT ONE OF THE FOLLOWING

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