VAT in the Kingdom of Saudi Arabia

VAT Regulations released for consultation

What's happened?

The Kingdom of Saudi Arabia has recently released draft VAT regulations for public consultation through the tax authority (GAZT) website. This follows an earlier consultation held in June on the KSA's domestic VAT law. The regulations, the law and the finalized GCC Framework Agreement form the entire foundations for the introduction of VAT across all sectors in Saudi Arabia from 1 January 2018.

Whilst the draft regulations remain subject to consultation and could change in some aspects, taxpayers have now been provided with the full complement of rules to understand their obligations and the impact of VAT for their businesses. A VAT registration process for the largest businesses has already commenced, and the draft regulations state that all other persons liable for VAT will be required to register by the end of September.

The regulations are an extensive document with more than 80 articles, and businesses should ensure they understand the full implications on their operations. This document looks at some of the headline details arising from the draft.

Which sectors are subject to VAT?

The GCC's Framework Agreement set some mandatory areas for zero-rating in all six Member States (such as exports of goods and services outside the GCC, medicines and investment metals). Individual countries are however able to elect whether exemptions or zero-rates apply in some other sectors.

The regulations reflect that Saudi Arabia has chosen a broad tax base: with VAT applying to almost all supplies of goods or services, subject to limited exceptions. The table below compares the VAT treatment of supplies signaled by the draft KSA regulations - in the sectors where an optional treatment is permitted - with a comparison to the recent public announcements made by the UAE Ministry of Finance in those sectors for information.

	Saudi Arabia Draft Regulations	United Arab Emirates VAT FAQs
Financial Services	Fee based services: taxable Margin based services: exempt	Fee based services: taxable Margin based services: exempt
Insurance	All non-life insurance: taxable Life insurance: exempt	All non-life insurance: taxable Life insurance: exempt
Food Items	All taxable	All taxable
Education *	Taxable	Specified services: zero-rated
Health *	Taxable	Specified services: zero-rated
Real Estate	Residential rental: exempt All other real estate: taxable	Residential rental: exempt Bare land: exempt New housing: zero-rated All other real estate: taxable
Local Transport	Taxable	Exempt

** We note that based on the draft regulations, services provided by public education and health providers in the KSA are not expected to be subject to VAT, as Government entities will in many cases not be carrying on a business for VAT purposes.*

VAT effects and obligations

It is clear that VAT will have a wide impact across all business sectors – even those who operate in a sector in which exemptions or zero-rates apply to some transactions. The release of the draft regulations gives us insight into these effects in more detail.

1. Core obligations

As an immediate step, all Saudi resident businesses will be required to assess their VAT-relevant turnover and, if required, to register for VAT with GAZT by 30 September 2017. The main VAT obligations will take effect from 1 January 2018: VAT must be charged on supplies made after this date, and tax invoices must be issued for all taxable supplies, showing a range of mandatory information. Each business will need to calculate the net VAT due over monthly or quarterly tax periods, with electronic submission of the VAT return and the payment due for that period required by the end of the following month.

2. Relief for small to medium sized enterprises

GAZT has acknowledged during public information sessions that the obligations of the new VAT system will be felt particularly by smaller businesses. Indeed, the draft regulations allow for the administrative burden to be eased from SMEs:

- Whilst the standard VAT registration threshold is SAR 375,000, businesses with annual turnover less than SAR 1,000,000 are initially exempt from the mandatory registration requirement until January 2019, giving the smallest businesses more time to become ready for new rules;
- VAT reporting can be carried out on a 'cash accounting' basis for small businesses with turnover of less than SAR 5,000,000 – removing the administrative obligation of invoice accounting, and the additional VAT burden arising from unpaid customer debts for these businesses;
- All businesses with annual turnover less than SAR 40,000,000 may use a quarterly filing period, significantly reducing the number of VAT returns required per year and extending the time for making payment of VAT.

3. Deductions of VAT

A deduction may be made for any VAT inclusive purchases in the period the purchase was made – without an onwards sale or supply being made at the time. Purchases however must ultimately relate to taxable supplies to be deductible. Where businesses make both taxable and exempt supplies, a proportional deduction calculation must be made: by default, this is calculated based on the value of taxable and exempt supplies made, but other methods may be used following agreement of these with GAZT. In all cases, any VAT deduction requires the purchaser to hold a copy of a valid tax invoice issued by the supplier; therefore, the process of collecting and reviewing purchase invoices will be a vital step for taxpayers.

Deductions of VAT will not be permitted for entertaining, catering, and purchase or expenditure on 'restricted' motor cars – i.e. those available for any private use. VAT incurred on these items will be an additional cost to business.
Where VAT deductions exceed VAT charged on supplies – and the taxpayer is in a VAT repayment position, a refund of this VAT can be requested from GAZT, or the balance may be offset or carried forward. Refunds of VAT will be particularly important for exporters and other businesses who expect to often be in a VAT repayment position.

4. Audit and assessment
The regulations set out that GAZT has broad powers to request information from taxpayers, and to carry out examinations or audits onsite or offsite. A formal VAT assessment may be issued by GAZT at any time up to five full calendar years following any tax period. In certain cases, this can be extended to 20 years.

However, taxpayers will be able to request formal review of assessments and many other GAZT decisions. This will first take place through an internal review process, but may also be appealed to a tax committee or resolved through mediation – provided, in the latter case, that both parties agree upfront.

5. Special rules for certain sectors and transactions
Outside of the standard obligations and transactions, the regulations consider many special and complex areas – businesses should be aware of these and the potential impacts. For example, the regulations provide rules describing:

- the use of a margin VAT calculation for suppliers of used vehicles;
- the sale of vouchers and use of those vouchers when purchasing goods or services;
- obligations of intermediaries, particularly for transactions in the digital economy;
- circumstances where VAT is not chargeable on the transfer of an economic activity (similar to 'transfer of going concern' rules); and
- procedures for non-resident businesses and tourists to recover VAT suffered on purchases in Saudi Arabia.

There is much further detail in the draft regulations – more than can be covered in this summary document – and yet, there are likely to be areas where the law and regulations do not consider a certain situation: so questions may remain for some businesses.

Next steps in consultation

A public consultation on the draft regulations closes on 19th August 2017. Details of the consultation, and a full link to the draft, is provided here. We encourage businesses to consider the effect of the regulations and respond during this process.

Our view

The publication of detailed regulations is a welcome development, allowing businesses to understand the detail of the domestic VAT rules, and the structure and makeup of the formal legal framework. Doubtless, there will be some areas where questions remain – but future taxpayers now all have the full information they should expect to use in their VAT readiness preparations.

At the time the draft regulations were issued, there was slightly more than five months until VAT comes into force in Saudi Arabia – and only ten weeks until VAT registrations will need to be completed and submitted. The coming months are critical to ensure your preparations for VAT are in order; and to ensure you have sufficient time to implement changes, test your processes and ensure readiness across your organization.

Where businesses are not ready for VAT, this may cause significant business disruption – such as the inability to fulfil orders, raise invoices, or approve purchases made after 1 January 2018. From a financial and reputational perspective, the penalty framework detailed in the draft law shows that penalties can be severe for VAT errors or non-compliance.

Getting ready for VAT

Immediate actions, if not already completed, should be:

• Assessing VAT readiness with GCC VAT Review Smart (VRS), Deloitte's online assessment tool, which considers everything from the financial impact of VAT, through to staffing and accounting process;
• Developing roadmaps through to early 2018 and develop a resourcing plan to identify the work necessary to be ready to submit VAT returns in 2018;
• Securing budget through a business case and your place in line with IT to manage systems changes;
• Mapping your transaction footprint to determine all future VAT liabilities and compliance obligations are easily overlaid;
• Reviewing whether systems capabilities meet standards required by local tax authorities, particularly regarding reporting and invoicing;
• Reviewing and updating contractual arrangements with vendors and customers to determine each party is aware of its responsibilities for paying and accounting for VAT; and
• Including appropriate caveats in contracts and implement changes to contractual terms, where required.

In the coming months, your actions towards a VAT ready state by 1 January should include:

• Introducing and documenting VAT policies, procedures and controls—especially for accounts payable and accounts receivable functions;
• Supply chain enhancement aimed at reducing adverse VAT cash flow impacts;
• Restructuring where necessary to determine minimal VAT 'leakage' occurs;
• Understanding the impact of VAT on pricing and working capital requirements;
• Testing of implemented systems changes and processes, including user-acceptance testing;
• Communications with third parties surrounding VAT;
• Role-specific training for all staff whose roles are affected by the VAT introduction; and
• A final review of key controls, systems and processes before the go-live date, and continuing review on an ongoing basis.

Deloitte will be holding client seminars in each of our KSA offices during August, to discuss the published VAT framework in the KSA, and the obligations for business. For more information, please follow this link.

Middle East VAT Services

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Contacts

Justin Whitehouse
Indirect Tax Leader
jmwhitehouse@deloitte.com

Bonny Teo
Senior Manager, Indirect Tax
boteo@deloitte.com

Matthew B. Parkes
International Gulf VAT Desk
matparkes@deloitte.com

Aamer Bhatti
Senior Manager, Indirect Tax
aabhatti@deloitte.com

Nauman Ahmed
Senior Director , Tax – Al-Khobar and Middle East Tax Leader
nahmed@deloitte.com

Nasser Sagga
Partner, Tax – Al-Khobar
nsagga@deloitte.com

Wissam Merhej
Senior Director, Tax - Riyadh
wmerhej@deloitte.com

Farhan Farouk
Senior Director, Tax - Jeddah
ffarouk@deloitte.com