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Value Added Tax in the GCC
Insights by industry | Volume 2

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Chapter 2 - Tourism industry

VAT and the tourism industry – a complex formula





Those involved in the tourism industry will know that it is not an industry that can be packaged together easily from a VAT perspective. There are many very distinct functions that are loosely categorized as part of the tourism industry, including airlines, travel agents, tour operators, accommodation and other local service providers. Each of these will be affected in one way or another by the application of VAT within the GCC.

Given the complexities inherent across these businesses and the Gulf region, the broader tourism industry in the GCC could well prove to be one of the more challenging areas in terms of addressing the impact of VAT.

A complex industry with many facets

The reason for this complexity is that VAT is, in many respects, both a tax on transactions as well as a tax that applies within a geographical area.

The impact of the former is that not only is it necessary to identify the various types of transactions that may be undertaken within the industry, but also the relationships that arise as a result of the transactions, ie. are the parties acting as 'agent' or 'principal'? Many tourism businesses describe themselves as an 'agent', but these businesses must

consider if they are acting as a principal in reality, while referring to themselves an 'agent'. This will be an important distinction as it will have a huge impact on the manner in which VAT needs to be accounted for.

The impact of the geographical aspect, is that the tourism industry will be dealing with both domestic tourism activities as well as international tourism – both inbound and outbound. This results in complexities over the 'place of supply' – which country VAT is due in – and the applicable rate. As an example, domestic tourism will typically be subject to VAT at the standard rate. Inbound tourism will most likely also be subject to VAT in the respective GCC state at standard rate.

Outbound tourism, may, on the other hand, be partially subject to VAT in the GCC at standard rate, and partially subject to VAT at zero-rate (or completely outside the scope of GCC VAT). Indeed, outbound tourism can in some respects be likened to an export of services, in that the supply of the tourism-related activity will occur offshore and probably be subject to VAT in the country in which the tourism actually occurs. To an extent, this will also depend on which functions are conducted in the GCC state and the capacity in which that function occurs.

Agent versus principal

By way of example, if a domestic tourist enters into a transaction with a travel 'agent' for an overseas travel package, and in accordance with which that 'agent' arranges the overseas flight, the accommodation, tours and transport overseas, the services would likely be treated as zero-rated from a GCC perspective as the underlying supply will actually occur offshore (typically by businesses that are based offshore and would not be registered for VAT purposes in the GCC). The treatment of the charges made by the 'agent' for his services, might, however, depend on whether the 'agent' is acting in the capacity as agent or as a principal in its own right.

In this case, it is the movement of the tourist that in many ways determines whether a supply will be zero-rated or subject to VAT at standard rate, rather than the travel agent's VAT status. In this respect, it could be seen as counter-intuitive that although the agent's services may occur in the relevant GCC country, and indeed payment may occur here, the services (being the air transport, accommodation, tours etc.) will occur offshore, and are likely to be subject to VAT there. Agents will be required to carefully review each travel package to determine the correct VAT treatment.

As for the agent's own services, while they physically occur in the GCC, the normal legal or contractual relationship will be between the 'agent' and the offshore service provider – ie. the hotel, car hire company etc. The agent is normally paid by them (rather than by the traveler), and as such it is the agent's services to those providers that could be subject to VAT at zero-rate, as it is those services that are being 'exported'. Of course, if the 'agent' is contracted to the onshore 'tourist' (possibly a company that is operating onshore and arranging to send employees overseas for work purposes) then those

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services may well be subject to VAT, but this would depend upon a number of other factors that need to be considered.

Operations of an accommodation provider (hotel, motel etc.)

The organizational structure of hotels varies according to the size of the hotel and the services offered, and the sources of revenue and expenses in the operations are likely to vary according to the range of activities provided.

It will generally be common to most hotels for their revenue streams to include accommodation (room revenue), food and beverage or F&B revenue, telecommunication (both telephones, TV/movies, and internet revenue), recreation revenue (weddings and other functions) and other rentals (conferences, exhibitions, etc.). The VAT implications of each revenue stream will need to be considered and separately itemized for invoicing and accounting purposes.

One of the interesting issues for hotels will be the recognition of the time of supply for VAT purposes. Traditionally, hotel operators tend to recognize income from room revenue at the date of the guest's arrival at earliest, although many also recognize it at date of departure, based on the premise that prior to that time, the booking may have uncertainties associated with it (the guest may depart earlier or later than their booking may initially indicate).

This can cause issues from the perspective of establishing when the 'time of supply' occurs for VAT purposes, particularly based on the fact that many hotels will take a 'swipe' of the guest's credit card on arrival. Time of supply in relation to the supply of services is usually based on the earliest among payment, invoice, or completion of the supply by the service supplier. The question then becomes whether the terms and

conditions of the hotel have the potential to render either one of those instances to have triggered the 'time of supply' for VAT purposes prior to the date on which the supply is considered by the hotel operator to have occurred. Indeed, it is possible that hotel providers will be required to account for VAT to the authorities before full payment is received or before revenue is recognized.

Other issues that may need to be considered include those identified in our earlier article on the MICE industry in Volume 1 of the whitepaper, particularly relating to the booking of events, conferences and exhibitions that may have long lead times, and contracts that may pre-date the implementation date of VAT.

Tour operators

The treatment of VAT for tourism operators can vary from being relatively simple to being a lot more complex than operators may be able to feasibly handle. This complexity may drive some operators to make changes to the way in which they do business.

In its simplest form, tourism operators will generally find that, assuming they breach the threshold for being required to register for VAT, they will need to charge VAT on their fees. This will be despite the fact that a significant percentage of their client base will be tourists from offshore, and also that many of the tours may in fact be booked while the tourist is physically situated outside the country. The reality is that the authorities are likely to take the view that the service is supplied in the respective GCC state, and that it should therefore be subject to VAT there.

At a more complex level, a tour operator may find that the tours that it currently offers will take tourists between two, or more of the GCC states. This may then 

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require some form of apportionment between the standard rating of the supplies in the GCC state that it is registered in as a primary operation and zero-rating for the ‘international’ element. It may also require registration and VAT reporting in multiple GCC states. Balancing against this added complexity and the requirement to charge VAT to foreign customers, the tour operators should be able to recover VAT they have incurred on costs as input tax, but once again there may be a need to split those costs between GCC states. Some countries do offer special arrangements for tour operators to alleviate certain challenges (in Europe, the so-called “Tour Operators Margin Scheme”), but it remains to be seen if this will be offered in the GCC.

Airlines

This is an area potentially deserving of its own article due to the possible complexities. The VAT treatment for a large portion of sales would appear simple, given that there are few, if any, domestic flights undertaken with the GCC (with those within Saudi Arabia and Oman being the obvious exception). As a result, most flights would be expected to be zero-rated on the basis that they are international flights.

The issues and complexities that arise typically do so as a result of the various ‘non-airfare’ charges made to customers, and other fringe operations that airlines often engage in outside of their core operations of transporting people and goods around. On the revenue side, one of the more obvious examples would be their participation in frequent flier programs.

While the treatment of these in relation to points accruing to fliers is generally relatively uncontroversial, the issues that

arise will occur when it becomes one of the treatment of the supply of the various rewards that may be provided, and also the treatment of the possible supply of participation ‘points’ to banks, financial institutions etc. that use them as incentives for customers to spend money using branded credit cards etc.

An interesting area for airlines will be around the ‘time of supply’, particularly in relation to the sale of airline tickets. The normal rules for a service of this nature would require the VAT recognition date to be the earlier among payment for the service, the issuing of an invoice, or the actual completion of the supply of the service.

The issue here is that the supply of the airline booking is typically only completed on payment (whether actual payment, or the ability to charge an amount to the traveler/the traveler’s employer for the flight). However, this needs to be considered in the context of the fact that the underlying supply (the travel from A to B) will only occur if, and when the traveler arrives at the airport, gets on the plane, and then eventually arrives at the destination.

Matters have the ability to become confused where the traveler either does not arrive at the airport (and therefore does not actually travel), or arrives at the airport to find that the flight is overbooked - and therefore is not able to fly, or is offered either an alternative flight or some other arrangement, including ‘compensation’ in some form.

Clearly, in the former situation, the service of the flight has not been delivered, so a potential issue to consider is whether there is some other form of service that has been delivered – and if so what that

service is. If a separate service has in fact been delivered, could this be viewed as inextricably linked with the zero-rated flight that it also should be zero-rated? In the second case, where the traveler is wait-listed, has the service been delivered? This question has a significant VAT reporting effect if wait-listing occurs at the end of the tax period, and if the actual replacement flight occurs during the next month.

This is one small example of the complexities that will be faced by the airline industry.

Another area where airlines will have issues is in the recovery of VAT incurred locally on fuel, services and capital assets. This has the potential to impact significantly on their cash flow, and hence working capital depending upon the precise treatment afforded claims for refunds. Ignoring the prevalence of leasing of capital assets for one moment, if one considers the value of a new aircraft when

first imported, the VAT on importation, and the consequent potential for an outflow of VAT, followed by the delay in any refunds, this cost could at best be considered as daunting.

Conclusion

The tourism industry contributes significantly to the Gulf economies and offers immense opportunity for individual operators throughout much of the GCC, but all such operators will face major complexities in the manner in which they will need to address the implementation of VAT.

It is clear from the subjects discussed in this article, that we have merely scratched the surface as to the potential complexities. To give sufficient time to resolve complexities and be ready for a successful introduction of VAT, the players within the industry would do well to begin their implementation processes earlier rather than later. ●

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