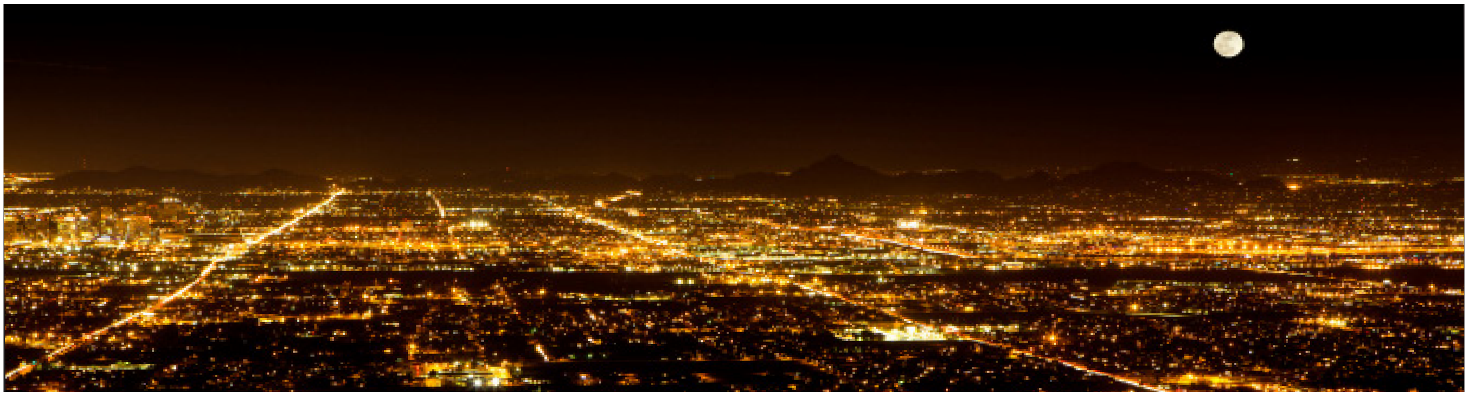
Value Added Tax
June 2017



VAT in the Kingdom of Saudi Arabia

Draft VAT law released for January 2018 commencement

What's happened?

The Kingdom of Saudi Arabia has released a **draft domestic VAT law** for public consultation. This follows the public release of a **VAT Framework Agreement**, signed by each of the six Member States of the Gulf Cooperation Council (GCC). Together, the law and the Framework Agreement lay the legal foundations for VAT to be introduced across all sectors in Saudi Arabia from 1 January 2018.

We expect, later in June, the release of Regulations detailing domestic specifics of the VAT system being introduced in Saudi Arabia, including the goods and services which will be exempt or zero-rated. In the meantime, the General Authority for Zakat and Tax (GAZT) has intensified their program to publicize the impending VAT system and educate businesses on their obligations

Effects and obligations of VAT

VAT is designed to be a broad tax affecting businesses in all sectors. **Any business above an annual turnover threshold of SAR375,000 must register for VAT and charge VAT on goods or services supplied.** Although we expect some sectors (such as financial services) to have exemptions on certain income, VAT will by default apply to all transactions in Saudi Arabia. Businesses must be prepared to charge a 5% VAT on sales, and pay 5% VAT on purchases – although a credit will be available in principle for VAT paid on purchases. In this way, VAT is not intended to be an extra cost for most businesses: but the draft Law signals additional administrative requirements.

Upon the introduction of VAT, registered businesses must issue formal VAT invoices for each supply (it may be required that these are issued electronically). Businesses must maintain these invoices, and keep formal books to allow preparation of periodic VAT returns. GAZT has indicated that returns are likely to be quarterly or monthly, and must all be filed electronically. The Framework Agreement confirms that records must be retained for at least five years.

Domestic specifics of VAT law

The draft law released for Saudi Arabia provides the legal basis for the introduction of VAT domestically, and leaves many details to Implementing Regulations. Nonetheless, some interesting themes can be read from the draft law itself:

1. VAT will be a self-assessing tax: each registered business will make an assessment of tax by filing VAT returns, and will be responsible for ensuring returns are correct – otherwise severe penalties may apply.

2. Administrative simplifications will be introduced: the law allows for a group registration status, to have a single set of obligations for businesses in a group, and includes a 'cash based accounting' system to allow certain business to calculate VAT based on cash received. These can greatly reduce compliance costs for eligible businesses.

3. The powers of GAZT will be extensive: the law signals that GAZT will have broad powers to request taxpayer information (including from third parties), to 'redescribe' transactions in cases of avoidance, and to hold other persons jointly liable for VAT obligations and payments.

Be aware

Dealing with the authorities:
GAZT realizes the significant change required for both businesses and within its own organization to be ready for VAT to be introduced by 1 January 2018. It has started building its capacity for dealing with enquiries from businesses, and managing new taxpayers. Larger taxpayers will have dedicated 'relationship managers' within GAZT to deal with their ongoing VAT affairs. A process has already commenced for GAZT to register the largest 250 domestic businesses in readiness for VAT introduction. For other businesses, the ability to start registration formalities may commence from as early as the third quarter of 2016.

Penalties and fines for non-compliance:
A broad range of penalties may be applied for non-compliance. The draft VAT law includes ten penalties for specific errors or offences, a general penalty, and two more severe penalties for deliberate breaches (including imprisonment in the most severe cases). Notably, a fine of 50% of the tax due is by default imposed for errors in tax returns and claims. However, penalties may be exempted or suspended. The penalty regime provides incentives for businesses to get their VAT obligations right: we would however hope that in practice exemptions and suspensions are applied sensibly by GAZT to encourage voluntary compliance.

VAT on cross-border trade

Common with most other countries, **the Framework Agreement confirms that a zero-rate will apply to export transactions.** VAT may however apply to some cross-border trade: a set of 'place of supply' rules dictate which country VAT is charged in on intra-GCC trade. It is possible that other Member States will not have their domestic systems in place by 1 January, so some transitional measures may apply during the interim. VAT will apply to imports of goods and to most services received from outside the GCC.

Immediate Actions

The announcement of draft law is a further reason for businesses to accelerate their VAT readiness preparations. Preparation is key because VAT liabilities are generally self-assessed, with errors often subject to severe penalties and time consuming interactions with local tax authorities, or worse, causing a business disruption.
Immediate actions, if not already completed, should be to:

- Assess 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
- Develop roadmaps through to early 2018 and develop a resourcing plan to identify the work necessary to be ready to submit VAT returns in 2018
- Engage in dialogue with industry groups and authorities surrounding any high-impact or complex areas of law
- Map your transaction footprint to determine all future VAT liabilities and compliance obligations are easily overlaid
- Review and update contractual arrangements with vendors and customers to determine each party is aware of its responsibilities for paying and accounting for VAT
- Include appropriate caveats in contracts and implement changes to contractual terms, where required

Getting ready for VAT

In the coming months, actions to build towards a VAT ready state should include:

- Reviewing whether systems capabilities meet standards required by local tax authorities, particularly regarding reporting and invoicing
- Introducing and documenting VAT policies, procedures and controls—especially for accounts payable and accounts receivable functions
- Planning for transition periods can often involve determining systems are capable of recognizing more than the standard number of tax rates
- 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
- Securing budget through a business case and your place in line with IT to manage systems changes

Next steps

A public consultation on the draft VAT law closes on 29 June. Details of the consultation, and a full link to the English and Arabic draft, are provided **here**. We encourage businesses to consider the implications of the law and respond during this process. Regulations are expected to be issued by the end of June.

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Middle East VAT Services

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