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Value Added Tax
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GCC VAT Fundamentals in the Financial Sector

The introduction of VAT is a landmark event for the region and marks the true beginning of VAT implementation across the GCC. The VAT Treaty signed by the GCC states establishes the common principles of the VAT system which is to apply in each GCC State and provides a structure on which domestic VAT legislation will be developed. We are gradually getting clarity over the principles which every State will be required to enact and can start to confirm our understanding of how businesses will be impacted by the introduction of VAT within the region. The Treaty however leaves certain decisions to the discretion of the individual GCC States, so whilst we now have a greater understanding of how the VAT system will operate there remain many 'grey' areas which can only be resolved once each of the countries have released their VAT laws.

VAT will be relatively straightforward conceptually

- Registered suppliers charge VAT (output tax) in most instances (i.e. typically added to current prices)
- Registered business customers recover the VAT (input tax) in most instances
- End consumer suffers the total VAT cost; flows through businesses to a great extent
- Standard VAT rate will be 5% across the GCC

Zero-rated

- No VAT charged to customers but can recover input tax
- Zero-rated traders usually in a repayment position

Exempt

- No VAT charged but no input tax recovery
- Exempt traders have a higher cost base and often increase prices as a result

What will be the VAT liability for supplies in the financial sector?

Financial services provided by banks and financial institutions will be exempt from VAT in the GCC states as per Article 36 of the Treaty:

- **Exemption will apply to licensed banks and financial institutions** according to Article 36 of the Treaty, however the Treaty also allows GCC States the discretion to apply any other mechanism to financial services. **Need to ascertain what qualifies as a financial supply** – interest on loan, forex transactions and other margin based products likely to be exempt, while fee based products may be standard-rated and will this apply to unlicensed institutions?
- Exemption leads to a sticking VAT cost within the supply chain as VAT incurred on purchases is irrecoverable – so **increased cost for the financial services provider**
- **Will insurance be treated as exempt, it is not clear that it will and more modern world wide VAT systems have tended to tax it (as a replacement for insurance premium taxes)**
- **Zero-rating likely to apply to products sold offshore** i.e. to non-GCC clients
- Islamic banking products are likely to be synthetically treated in the same way as the equivalent non-Islamic products
- **Each GCC country is likely to have quite different rules**

There will be issues...

- Deciding what constitutes a financial supply to be exempt from VAT
- **Multiple VAT liabilities** on supply side due to differential treatment for different supplies in the financial sector
- **Recovery of VAT** as VAT incurred on purchases related to exempt supplies would not be recoverable as input tax

Commercial opportunities for banks...

- **Banking clients will have substantial new working capital requirements** (VAT creates substantial cash flow issues for businesses)
- **Increased demand for lending products** as consumer purchases may get accelerated before VAT implementation

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