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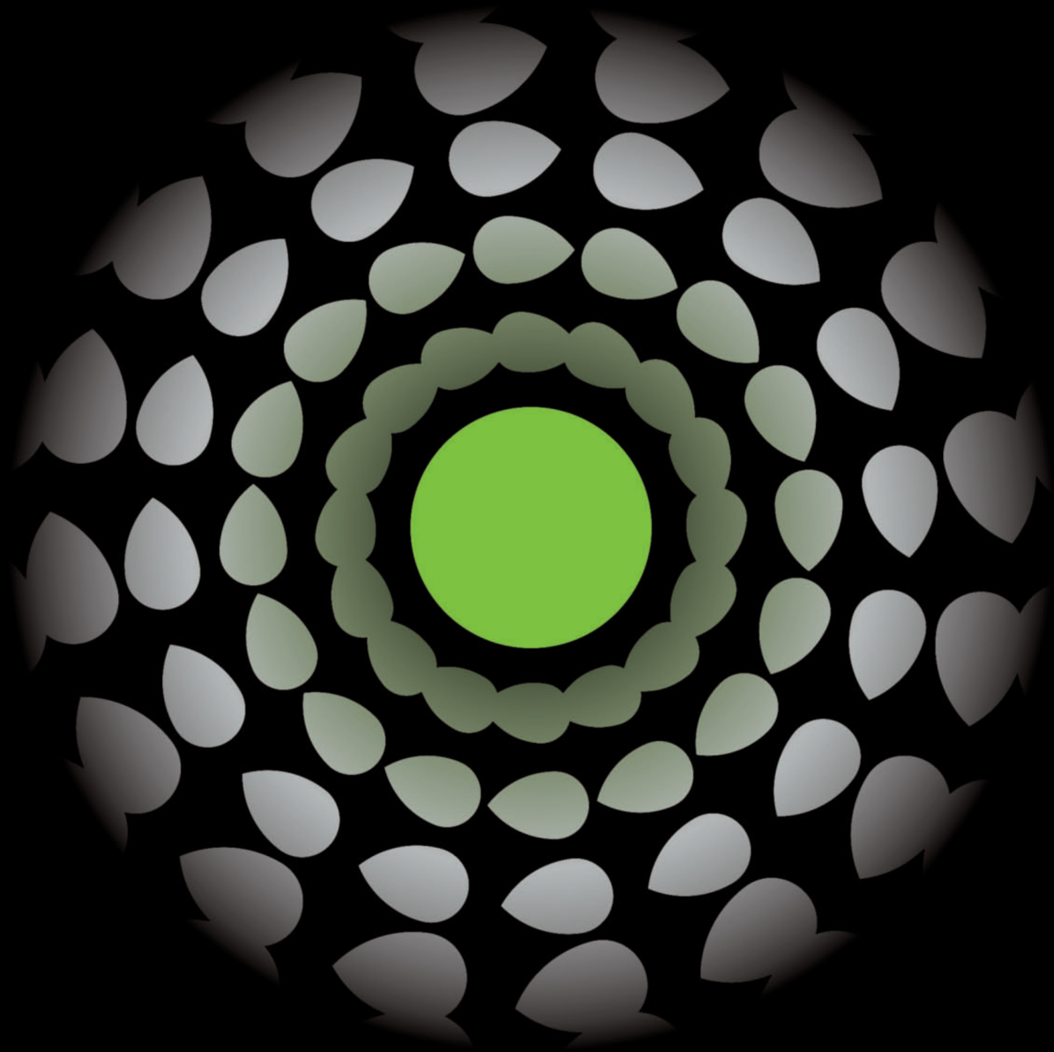

Value Added Tax in the GCC

Insights by industry | Volume 3

In the Middle East since 1926

Chapter 3 – Family offices

Why are family offices relevant to the VAT conversation?

Every family office operating in the GCC will be affected by VAT because anything purchased in the GCC is likely to be subject to VAT.

Reaching a consensus on the definition of a family office is something the wealth management industry and families themselves are unlikely ever to achieve. It is, however, widely accepted that "once you have seen one family office, you have seen one family office"[1] and so with this in mind, we will consider some of the more common attributes of family offices in the GCC and how their activities will be affected by the implementation of VAT.

Many family offices help administer the personal finances of the family members, liaising with bankers, lawyers and trustees on their behalf. In other family offices the depth of the financial services provided is much more akin to a commercial asset manager, with analysts and researchers employed to manage the family's wealth.

There is also often an element of concierge/PA type services provided whereby the team will assist the family with travel arrangements, including visas, sourcing specific items or services, or booking tickets for various events. Administrative functions often include bill payments, coordinating calls, document management etc.

Family offices often get involved in the management of luxury assets and real estate, either directly or indirectly. They are often the first port of call for advisers and service providers and act as a gatekeeper for their principal/s.

One of the critical functions of the family office is to liaise with the family business, particularly when it comes to cash flow or treasury management. This provides the team with a unique perspective over all of the family's interests.

Funding invariably comes from the patriarch, or the founder. In some more structured families, the family office is effectively a filter between the family and the business, allowing it to withhold funds from dividend payments received from the business before distributing to family members accordingly. This ensures that contributions to the family office running costs are shared amongst the members making use of the team's services, and also enables the family office to fund some of the family fundamentals, e.g. health insurance, education, philanthropic endeavors as mandated by the founder.

Why are family offices relevant to the VAT conversation?

As described above, the variety and breadth of services that family offices can and do provide mean that it is difficult to generalise; the extent of exposure to VAT of each family office will of course depend on the particular facts of each structure.

However, every family office operating in the GCC will be affected by VAT because anything purchased in the GCC (e.g. computers, mobile phones etc.) is likely to be subject to VAT. Unless they are able to reclaim the VAT on these items ("inputs"), then the family office will see their costs rise.

In order to be able to recover the VAT on the inputs, then the family office must register for VAT in the same way as trading businesses must register for VAT and they may have to charge VAT on any "outputs" (i.e. services provided). The time and financial cost implications associated with being VAT-registered may, in some instances, outweigh the advantages of being so registered. Furthermore, as explained further below, the option of registering for VAT may not even be available to the family office.

Irrespective of their registration status, family offices will inevitably be dealing with VAT-registered businesses as suppliers, or advisers to the family, and they will need to ensure that the VAT is treated correctly here too.

The family office VAT paradox

Many family offices appear to be run as businesses. They may be established as a separate legal entity with family shareholders, often with a full board, robust governance, employees and bank accounts separate from those of the family or family business. Other family offices may be less formally constituted and have evolved from within the finance function of the family business, but are still run along commercial lines, with ledgers and budgets prepared regularly.

Both types of family offices are likely to be funded by the family, either directly, or indirectly via the family business. Before distributing dividends to the family, the family office may deduct an amount for their costs, or for providing services to them; a percentage of investment returns may be paid to the family office, or family members may transfer funds directly from their own personal accounts.

Irrespective of the funding or structural arrangements, it would be unlikely that a single family office would be run with a view to realizing profits. Consequently, family offices are notoriously difficult to classify in a VAT context.

In comparison to trading businesses, the incidence of family offices is relatively low. This is true of the GCC as well as other jurisdictions that already have a VAT system in place. Being a niche 'industry' there is often no specific statutory guidance for family offices, and so they are often dealt with by the local tax authorities on a case-by-case basis. The GCC countries have not yet indicated how they intend to treat family offices; whether they will recognize the paradox and allow family offices to register, or whether they will apply the business test as a pre-requisite. Only once they have had an opportunity to analyze several family offices on the facts can we expect more specific guidance on how family offices should be treated for VAT purposes.

Implications for a family office which is not registered for VAT

As an unregistered entity, the family office will be treated in the same way as an individual consumer. When they buy goods or services which are subject to VAT (and reflected in the price), the net cost to them will always be the VAT inclusive amount. This is because being unregistered means that they are unable to reclaim the VAT charged. Running costs will therefore inevitably rise.

On the other hand, the unregistered family office will not be required to issue VAT invoices and charge VAT on any services provided to the family. There will also be no requirement to report transactions to the tax authority.

Having an unregistered entity as part of the family structure can create difficulties for the family business. This is because the trading business will be at risk of penalties if they inadvertently reclaim the VAT on a supply of goods or services which are used wholly or partly by the family office.

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This can become an issue if the family business and family office share the same bank account (for then administratively it is difficult to establish where the expenditure should be allocated).

Another example is if the family office and the family business share office space, where one entity is registered and the other is not. For example, if the rent on the office space is subject to VAT, the VAT registered entity (the family business) will wish to reclaim the VAT paid. However, if part of the office is used by the family office, because they are not a business and cannot reclaim VAT on inputs, the VAT on their share of the rent cannot be reclaimed. Likewise with shared photocopiers, coffee machines, furniture in staff rest areas etc., the VAT on these items would normally be reclaimed in full by a registered business, but where there is also use by a non-registered entity, the calculation becomes problematic. And as for stationery supplies, will the family business wish, or even be able, to restrict access to pens, notebooks, calculators etc. to non-family office staff to enable them to reclaim the VAT in full?

Implications for a family office which is registered for VAT

In this instance, a VAT-registered family office can share office space, coffee machines and stationery supplies with the family business with little adverse impact on the family business.

When buying new computers, mobile phones or other office supplies, as a 'business' the family office can reclaim the VAT incurred in full. This means that even if they have to pay VAT, providing that the equipment is used for business purposes, VAT can be reclaimed, so it does not directly impact their running costs.

The trade-off of being a business and being able to reclaim input tax is a requirement to charge VAT on outputs, i.e. services provided to the family. Clearly, this will increase the cost to the family member since they, as individual consumers, cannot reclaim or offset the VAT on the services provided.

The family office has an obligation to collect the VAT charged and pay it over to the tax authorities in a timely manner, and so if there is a delay in family members settling their invoices, there is a cash flow impact for the family office. Ensuring that the invoices are correctly issued, that the VAT return is accurate and up to date is an additional administrative task with an associated time and financial cost. The family office is also exposed to the VAT risk in case of errors or omissions on the return.

Where some of the family members are resident in a different jurisdiction, and different types of services are provided to them, then the reporting becomes a little complicated and the 'place of supply' rules have to be considered. Usually the place of supply (and therefore the VAT rules that must be applied) is the place where the service is provided, but in some cases it can be where your customer belongs. The finance team associated with or part of the family office will need to be very careful that the VAT invoices issued correctly reflect the appropriate VAT rules when dealing with cross-border transactions.

Liaising with the family business

In the family business context it is not unusual to see a blurring between assets acquired for the company and assets acquired for the family. Sometimes there is also both personal and business use of the assets. From a VAT perspective, this means that the amount that can be reclaimed is restricted. Businesses must therefore be careful that they do not over-claim VAT on items which have a duality of purpose (i.e. are used for business and personal activities).

For example, consider a family member who decides he would like a new desk for use in the office. The business pays for this new desk and submits a VAT reclaim for the VAT incurred. The desk is delivered to the office two weeks later, and the individual decides that he would rather have it in his home office where in the evenings he deals with work emails, but also where he deals with his personal investment and residential property portfolios, family matters etc. The family office arranges for the desk to be transported to his home. It is possible that the finance team of the family business would not be immediately aware that the desk had been installed in his home and so may not qualify fully for a VAT refund.

Luxury goods

Private jets and yachts

The administration of high value luxury assets like jets and yachts is very often delegated to a specialist service provider who can also provide engineering maintenance, specialist storage and staff. However, the family office will invariably be the main point of contact for the service provider and will often liaise with them to arrange flights or to book charters, organize funding, or arrange transportation of the family's personal belongings, etc.

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The VAT cost of private jet charters is a complex area, which is outside the scope of this white paper. However, family office executives charged with administering this aspect of the family's travel arrangements should be trained on the high level issues involved, and know who to go to for professional advice if a new situation arises. Private jets that are not designed for commercial passenger transport are likely to be subject to VAT – but will this VAT be recoverable? This will depend on the extent of business use. We know for example that the KSA only intends to extend zero-rating to a means of transport which is not adapted for private use.

The acquisition of jets and planes will require specialist VAT advice, particularly when the usage will involve travel across borders.

Objets d'art etc.
Where VAT has been charged on antiques, jewelry, paintings etc. acquired outside the GCC, the family office is probably used to dealing with the VAT reclaim (under the export rules) for the GCC resident purchaser. The processes and procedures for dealing with such purchases will need to be updated to take account of the GCC VAT legislation.

The family office team, in conjunction with the family business finance team, should try to limit (or preferably avoid) such transactions being undertaken by the business for and on behalf of the family in the interest of keeping non-business purchases very distinct from business transactions.

Sporting activities
The extent to which family offices are involved in matters associated with race horses, camels and falcons etc. will differ from family to family. Where they are involved in providing funding for stabling, feed, vets bills, farm fees, transportation costs, etc., they will need to budget for the increased costs associated with the VAT rise. Since such ventures are, by and large, not run as a business, the VAT on these costs will not be available to reclaim. Any prizes (cash, cars, holidays etc.) will also then be outside the scope of VAT.

In some jurisdictions, the authorities have taken steps to allow owners to register for VAT, which allows them to reclaim the VAT on the expenses. As this is a reasonably niche area compared to the wider economy, we do not anticipate any specific scheme along these lines in the early years of VAT, but this may change over time.

Again it is imperative that the family business does not get financially involved in any of these transactions as there is unlikely to be a business purpose. Any commercial sponsorship by the family business of the animal(s), jockeys or trainers should be carefully dealt with and advice should be sought as to the deductibility of any VAT incurred.

How should a family office prepare for the onset of VAT?

The importance of segregating family and business expenditure to avoid difficulties with VAT has been emphasized in this white paper. However, such segregation is good practice in any event (for corporate governance, family governance and succession planning reasons), but the advent of VAT makes this exercise even more important to mitigate the risk of excess reclaims and under reporting of VAT, as well as to simplify the process for the finance team in the business.

A thorough review of the family office's processes and procedures should be carried out. Such processes should be classified between those relating to the family and those relating to the business so that appropriate restructuring and segregation of staff, entities or bank accounts, etc. can be arranged.

A review of the expenditure of the family office should also be undertaken, with a view to identifying any non-family expenditure (i.e. business expenditure) and calculating the additional costs that VAT will represent for the family office. Conversations with the CFO of the family business and family members should also be started sooner rather than later to agree on how the family office and the family members will deal with the increased costs. The family office may even want to reconsider the way it is funded and carries out business – careful restructuring may give a better 'VAT outcome'.

If the family business has appointed advisers to assist them with the implementation of VAT, then the family office should ensure that their role is fully understood and their requirements taken into consideration, since they will play a key role in ensuring a smooth transition for the family.

References
1. Attributed to Patricia M Soldano, Chair of GenSpring Family Offices' Western region, in the following Forbes article: www.forbes.com/sites/toddganos/2013/08/13/what-is-a-family-office/.

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