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Value Added Tax Is On the Horizon

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Saudi Arabia announced the introduction of Value Added Tax (VAT) in the recent budget. It is expected that the legislation would be issued sometime during ٢٠١٦ with implementation of VAT within ١٢ to ١٨ months thereafter.

VAT is generally considered as a tax on consumption. The more a person consumes goods and services subject to VAT (**VAT-able supplies**), the higher the VAT burden on that person. Basic essentials are generally excluded from the scope of VAT in order to reduce the impact on citizens. In this way, VAT could be considered as an incentive for people to consume less and save more.

Taxpayers and businesses need to prepare for VAT and different impacts will be felt by different businesses.

The author will be writing a series of articles on the impact of VAT on different industries. This is the first article in the series and discusses the general concepts of VAT based on prevailing laws and regulations around the world.

Why should business start preparing for VAT now?

VAT readiness will require businesses to look at all of their business processes. Whilst the Saudi VAT law has not been announced, VAT law, practice and methodology is generic in most VAT systems around the world, with slight adjustments to meet country specific requirements. Businesses can start to assess their readiness to meet these generic requirements now, updating their assessments for any Saudi specific requirements as they become known.

VAT readiness could require reconfiguring IT systems, which could take several months depending on the size of business and operations. System reconfiguration is a major exercise for a large organization and therefore, system readiness and testing could take anything from nine months to a year. Given this, preparations for VAT readiness should begin now.

Some basics of VAT

Generally, VAT applies to the supply of goods and services. Businesses making VAT-able supplies are generally required to register for VAT in order to collect VAT when making supplies to their customers. Certain businesses can be exempt from being required to charge VAT.

The standard rate of VAT in Saudi Arabia is expected to be around ٥٪ (**Standard-rated supplies**). However, certain goods and services could be subject to VAT at special rates (**Special-rated supplies**). In addition, certain goods and services could be subject to VAT at a rate of zero per cent (**Zero-rated supplies**). Certain supplies could be exempted from VAT altogether (**VAT-exempt supplies**).

Goods and services imported into a country are generally subject to VAT at the import stage. VAT in relation to import of goods is often collected by the customs authority at the time of release of the shipment. Generally, VAT on imported goods is applied on landed cost inclusive of the applicable customs duty.

Normally only VAT-registered businesses are allowed to charge and collect VAT on the supply of VAT-able goods and services (**Output VAT**). Against such output VAT, businesses are usually entitled to adjust any VAT paid on VAT-able goods and services procured by the business (**Input VAT**). The net VAT (Output VAT *minus* Input VAT) is then deposited into the national treasury.

While businesses making VAT-exempt supplies are not usually required to charge and collect VAT, such businesses are generally not allowed to recover Input VAT suffered on procurement of goods and services.

Standard-rated supplies

Most local supplies of goods and services in a country generally fall under this category. These can include whole-sale and retail sale of goods (including sales by retail stores), the consumption of food in a restaurant, the provision of services by lawyers, accountants, architects, etc.

Zero-rated supplies

Goods and services that are exported out of a country may be Zero-rated, that is, subject to VAT at a rate of zero per cent. Depending on the nature of service, the supplier may need to determine the 'belonging' status of the customer (i.e. whether the customer is a local person or an overseas person) before Zero-rating a supply. As VAT operates on the principle of 'consumption' within the country, it would be important to determine if the consumer is a national. Failure to make an accurate assessment can lead to imposition of penalties by the relevant tax authorities for failure to impose VAT.

In certain transactions, such as purchase and sale of land, even if the customer is outside the country, legal services for the acquisition of the land or architects services provided by a lawyer or architect in the country, may be treated as Standard-rated supplies.

VAT-exempt supplies

Whilst the final list of VAT-exempt supplies has not been announced, the following businesses are often exempted from VAT in order to reduce the impact on citizens:

- Educational institutions on tuition fees
- Pharmaceutical supplies (medicines)
- Financial Services including both banks and life insurance companies
- Sale or lease of residential property

In addition, it is often the case that VAT is not imposed on basic food items, such as, milk, flour, meat, vegetables, fruit etc.

While VAT-exempt supplies are good for the consumer, it may not be beneficial for the business that is engaged in making the VAT exempt supplies as it may disentitle the business from claiming any credit for input VAT.

It is likely that the Government would announce a detailed list of VAT-exempt supplies and an important consideration would be to minimize the impact on citizens.

Out of Scope supplies

Supplies where goods and services are delivered by an overseas supplier to another overseas person generally fall under this category as do private/non-business transactions.

Charging and collecting VAT

Businesses generally need to satisfy certain conditions for claiming Input VAT on business purchases and expenses. For example only the Input VAT on business purchases may be recovered and Input VAT incurred on non-business purchases would not be recoverable. As mentioned, only a business making VAT-able supplies can generally recover Input VAT.

Example

A dealer imports a vehicle for onward sale in the local market. The landed cost of the vehicle is SAR ١٠٠،٠٠٠ (inclusive of customs duty) and the vehicle is sold to the customer for SAR ١٥٠،٠٠٠. Assuming a VAT rate of ٥٪:

- Input VAT on import of the vehicle = ٥،٠٠٠ (١٠٠،٠٠٠ x ٥٪)
- Output VAT collected from the customer on sale of the vehicle = ٧،٥٠٠ (١٥٠،٠٠٠ x ٥٪)

SAR ٢،٥٠٠ is payable to respective tax authority after adjusting the Input VAT against the Output VAT.

VAT impact on businesses engaged in multiple activities

At times, a business may be engaged in a broad spectrum of activities which include making VAT-able supplies as well as VAT-exempt supplies. Generally, VAT legislation provides a formula for such businesses where the recovery of Input VAT is generally restricted in such cases to Input VAT paid on costs necessarily incurred in making VAT-able supplies.

VAT returns and payments

VAT-registered businesses are generally required to submit periodic returns to the respective tax authority and pay the related VAT into the national treasury. The frequency of the returns can be monthly, bimonthly or quarterly. Considering the current tax environment in Saudi Arabia, one could expect the submission of VAT returns and payments to be required on a monthly basis.

VAT returns are generally a simplified document summarizing different categories of VAT-able supplies subject to Output and Input VAT and the net amount to be deposited into the treasury or claimed as a refund (or carried forward for offset against the VAT liability for the following period).

Generally, there is no matching concept in VAT to match the Input VAT against the Output VAT for a particular supply. The net VAT payable for a period is the difference between the overall Output VAT and the Input VAT incurred in that period. Taking the above example, if the dealer is not able to sell the imported vehicle for six months, he should still be able to claim a credit for Input VAT paid on importation in the VAT return for the period in which the vehicle was imported.

What changes are needed for VAT readiness?

VAT is likely to impact different segments and businesses to varying degrees. Business will need to undertake a VAT mapping exercise of their current procedures and processes. Depending on the size and complexity of the organization and operations, VAT readiness can take anything between three months and a year. For example, VAT readiness for a manufacturer could extend to the following departments;

- Logistics and customs
- Finance
- Human Resources
- Sales and Marketing
- IT department for systems and EPR configuration
- Legal department

Other areas businesses would need to review could include their invoicing methodology, documentation retention policies and processes, and vendor and customer management and communication. It would also be important to review contracts to ensure that prices are not taken as inclusive of all taxes and charges (which could be interpreted as inclusive of VAT) and that the business is able to charge VAT on top of the existing prices.

Conclusion

VAT is likely to have a significant impact on business operations. VAT readiness needs to be considered and eventually implemented to try to ensure minimal impact on continuing business operations. If there is a single piece of advice one can give to businesses, it is to start VAT readiness preparations early.

About the author

Gurdeep Randhay is a Director at KPMG Al Fozan & Partners and leads the VAT practice. He can be reached at grandhay@kpmg.com for any clarifications in relation to the contents of this article.