

AN INTRODUCTION TO VAT IN THE GULF STATES

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Legal Briefings - By **Heather Gething, Stuart Paterson, Neil Warriner, Will Arrenberg and Scott Aitken**

A new Value Added Tax (VAT) is to be introduced in the Gulf States with effect from 1 January 2018.

Outline details of the tax are set out in a Treaty issued by the GCC in May 2017 which will be supplemented by Regulations and Guidance issued by the States.

This article is the first of a series of articles on GS VAT and provides an overview of how it will operate.

INTRODUCTION

This is the first of a series of articles on the new VAT to be introduced in the Gulf States.

In May 2017, The Unified Gulf Cooperation Council Value added Tax Framework Agreement (the "Framework Agreement") was published in furtherance of the GC Council's resolution in December 2015 to introduce a tax on consumption across the GCC Member States (the "GS"). It is clear that the Framework Agreement has drawn much of its inspiration from the European system of VAT.

The purpose of this article is to outline in simple terms how VAT across the GS is intended to operate and to indicate where difficult issues can arise in practice.

NOTE: This summary is based on the English translation of the Framework Agreement released on 3rd May 2017. If there is any difference between the English translation and the original Arabic version, the original Arabic version will prevail.

OVERVIEW - TAX ON CONSUMPTION

In overall concept, VAT is a relatively simple tax on consumption. Its essence is as follows:

- Supplies of goods or services by a business in the GS attract a charge to VAT.
- The business adds VAT to the charges for the supplies it makes to its customers (this is referred to as output tax) and, subject to the next point, pays over the VAT so collected to the tax authorities.
- If a customer receiving a supply is itself a business, it also charges its own customers VAT on the supplies it makes to them and pays over its output tax to the tax authorities, but only after having deducted from such VAT the amount of VAT on the supplies made to it that it has used to make its own business supplies (this is referred to as input tax).

If a customer receives any supply that it does not use for the purposes of making its own business supplies, that customer is not entitled to any deduction for the VAT paid to its supplier - it is the ultimate 'consumer' who effectively bears the economic cost of the VAT when it pays its supplier. No input tax deduction is therefore available for vat on such goods and services.

A SIMPLE EXAMPLE

To take a simple example: B is a carpenter who makes and sells furniture; he buys some wood from A for SR10,000 and uses it to make a table that he then sells to C for SR12,000 for use in C's home. Applying VAT to this at a rate of 5%:

A would charge B SR10,000 plus VAT of SR500 for the wood and A would hand that SR500 (received from B) over to the tax authorities;

- B would charge C SR12,000 plus VAT of SR600 for the table, but would be entitled to deduct from that SR600 collected from his customer C, the SR500 of VAT he paid to his wood supplier A, so B would hand over to the tax authorities only SR100 of VAT;
- C would pay B SR12,000 plus VAT of SR600 for the table but would not be entitled to deduct the VAT from anything because C will use the table for his personal benefit;
- In this way, the tax authorities have received VAT of SR600 through the medium of A and B (the businesses), and C (the ultimate consumer) has effectively borne the economic burden of that VAT. B has made a profit of SR2,000, having collected SR12,600 from C, paid out SR10,500 to A and paid out SR100 to the tax authorities.

Applying terms used in the GCC VAT Agreement, A and B in this example are each a 'person subject to the tax' who make 'supplies subject to tax' which tax is 'output tax', and the SR500 of VAT that B pays A for the wood is from B's perspective 'input tax' that is 'deductible tax' from the SR600 output tax he has charged his customer.

However, having said at the start that the essence of VAT is relatively simple, unfortunately a number of details underpinning the way VAT should operate are rather more complex.

SUPPLIES SUBJECT TO TAX AND EXEMPT SUPPLIES

For GCC VAT purposes, supplies can be:

- Subject to tax at the rate of 5%;
- Subject to tax at the rate of 0%; or
- Exempt from tax.

INPUT TAX DEDUCTION DEPENDS ON A BUSINESS MAKING TAXABLE SUPPLIES

The importance of this distinction lies in the ability of a business customer to obtain a deduction for its input tax on the supplies made to it from the output tax it is required to pay to the tax authorities in respect of its own supplies to its customers. The general rule is that a business can deduct its input tax from its output tax when handing over the VAT to the tax authorities only to the extent that it has used the supplies it receives on which it has paid the input tax for the purposes of making supplies subject to tax (either at the 5% rate or the 0% rate). But it cannot deduct its input tax in this way to the extent that it has used the supplies on which it has paid the input tax for the purposes of making exempt supplies.

To illustrate by reference to the example above, if supplies of wood were subject to 5% VAT but supplies of tables were exempt from VAT, B would still pay SR10,000 plus VAT of SR500 to A for the wood, but B would not be able to charge VAT to C on top of the SR12,000 for the table, nor would B be able to deduct the SR500 of VAT paid to A (B's input tax) from anything. So B's profit would effectively be reduced from SR2,000 to SR1,500; to maintain his profit of SR2,000, B would need to charge C SR12,500 (exempt from VAT) for the table.

GCC MEMBER STATES TO DETERMINE WHETHER SUPPLIES TAXABLE OR EXEMPT

Apart from financial services, which are to be exempt from tax unless a GCC Member State decides to treat them differently, and imports of certain goods, which are to be exempted from tax, most supplies of goods and services will be subject to tax at the 5% rate unless, in relation to certain specified matters such as education, health, real estate etc, a GCC Member State chooses to zero rate them or exempt them.

INTERNATIONAL SUPPLIES OF GOODS AND SERVICES - WHERE IS VAT PAID?

The basic summary and example above are relatively straightforward in obvious cases in which the goods or services are clearly supplied and received entirely within one GCC Member State. But what about goods or services supplied between GCC Member States, or goods or services supplied into (or from) the GS from (or into) non-GS countries?

Intra-GS supplies of goods

The general rule is that an intra-GS supply of goods takes place where the goods are at the time they are put at the customer's disposal or, if the goods are supplied with transport, where the goods are when the transport begins. In general, this is likely to mean that the supplier will account for VAT in the supplier's GCC Member State.

There are exceptions to this general rule, for example:

- in respect of supplies of goods with transport, where the customer is in business and subject to VAT in another GCC Member State, or where the customer isn't in business or subject to VAT and the supplier is itself registered or liable to be registered for VAT in the GCC Member State to which the goods are sent; in these cases, VAT arises in the GCC Member State to which the goods are finally sent;
- supplies of gas, oil, water and electricity to a VAT-registered trader whose main activity is the distribution of gas, oil, water or electricity take place where the trader has its head office, and where those supplies are made to a non-trader in those commodities, the supplies take place where the commodity is consumed.

Where the recipient of goods is subject to VAT in its GCC Member State and it acquires those goods from a resident of another GCC Member State, the person responsible for accounting for the VAT arising will be the recipient of the goods under what is referred to as the 'reverse charge mechanism'; this means that, broadly, the recipient of the supply accounts for VAT in its GCC Member State as if it had supplied the goods to itself and it can then claim a deduction for the input tax element of this self-supply from the output tax it has charged on supplies to its own customers.

Intra-GS supplies of services

The general rule is that intra-GS services are supplied:

- Where the supplier belongs if the customer is not subject to VAT (and the supplier will be

liable to pay the VAT to the tax authorities);

- Where the customer belongs if the customer is subject to VAT (and the customer will be liable to pay the VAT to the tax authorities under the 'reverse charge mechanism' described above).

There are however a number of special rules applying in specific cases, particularly where the services relate to transport, real estate, electronically supplied services, among others.

Imports of goods from outside the GS

- VAT arises on imports of goods in the GCC Member State that is the first port of entry into the GS.
- The person liable to pay the import VAT to the tax authorities is the person identified/acknowledged as the importer in accordance with the Common Customs Law.

Imports of services from outside the GS

- Where a person subject to tax in a GCC Member State receives services from a person outside the GS, the 'reverse charge mechanism' applies and the person receiving the supply of services accounts for VAT accordingly.
- As mentioned above, the input tax element of the reverse charge is deductible if the recipient of the supply itself makes supplies subject to tax to which the services relate.

Exports of goods to outside the GS

- The export of goods to outside the GS is subject to tax but at the zero rate.

Exports of services to outside the GS

- The supply of services by a resident of a GCC Member State to a non-GS resident who benefits from the services outside the GS is subject to tax but at the zero rate, save in relation to certain specific supplies as referred to above (services relating to transport, real estate, electronically supplied services, among others).

TIME OF SUPPLIES

The time at which a supply is made or received is important for the purposes of correct record-keeping and payment of tax to the tax authorities (see further below).

Time of Supply of goods

In general, a supply of goods takes place on the earliest of the following dates:
o when the goods are put at the disposal of the customer (if they are not being delivered);

- when delivery commences (if they are being delivered);
- when installation/assembly of the goods is completed (if the supply involves such installation/assembly);
- when a tax invoice for the supply is issued.

Imports of goods take place at the date of first importation into the GS (but note the payment of tax provisions for imports of goods, below).

Time of supply of services

As regards a supply of services, it generally takes place on the earliest of the following dates:

- when the services are performed;
- when (and to the extent) the services have been paid for;
- when a tax invoice for the supply is issued.

In relation to a continuous supply of services, a supply will take place each time a payment is made or an invoice for payment is issued, whichever is the earlier, at least once in every twelve month period.

WHO MUST BE REGISTERED FOR VAT?

Any resident of a GCC Member State who is subject to the tax must register for GCC VAT purposes if the value of its supplies subject to tax is SR375,000 (or its equivalent) per year. If a supplier makes only supplies taxable at the zero rate it may ask for exemption from compulsory registration.

Voluntary registration

Any resident of a GCC Member State who makes supplies with a value of more than half of that VAT threshold of SR375,000 but less than SR375,000 may choose to register if it so wishes.

Payment of VAT

A person subject to the tax who is registered or liable to be registered for GCC VAT must account to the tax authorities for its net VAT in relation to periods to be specified by each GCC Member State, though any given period cannot be less than a month (using the Gregorian calendar). Tax returns will be required for each specified period containing information about supplies of all kinds (taxable at the rate of 5%, taxable at the rate of 0% and exempt) made and received in that period.

The general principle is that the person liable to pay the tax is the supplier, albeit the parties to a contract will likely often provide that the economic burden for that VAT falls onto the recipient of the supply. However, if the 'reverse charge mechanism' operates then the person liable to pay is the customer. In relation to imports the person liable to pay is the importer, though it may be entitled to suspend payment of VAT if a customs duty suspension scheme under the Common Customs law applies and it may be entitled to adjourn payment if it uses the goods imported for making its own business supplies.

OTHER MATTERS

The Framework Agreement contains more detail about the matters summarised above, as well as provisions dealing with other aspects such as deemed supplies, claims for repayment of VAT, exchange of information between GCC Member States, transitional provisions and objections and appeals. Regulations are expected to supplement all of the provisions in the Framework Agreement. We will examine these in detail in forthcoming articles.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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