Executive summary

On 30 January 2017, the Shura Council in Saudi Arabia announced the approval of the Gulf Cooperation Council (GCC) Value Added Tax (VAT) Framework Agreement. Officials at the Saudi Arabian Ministry of Finance have indicated that the VAT regime will be applicable from 1 January 2018, and a 5% levy will apply to goods and services as set forth in the GCC agreement.

On 1 February 2017, Bahrain’s Minister of Finance H.E. Shaikh Ahmed bin Mohamed Al Khalifa signed the unified GCC VAT Framework Agreement and reaffirmed the expectation that VAT will take effect from 1 January 2018, after completion of the due constitutional and legal process. On 12 February 2017, Younis Al-Khouri, Undersecretary at the United Arab Emirates (UAE) Ministry of Finance reaffirmed that the GCC governments were planning early simultaneous adoption of VAT with 1 January 2018 as the anticipated effective date.

These official affirmations are in line with similar pronouncements made by government officials from other GCC Member States. The text of the GCC VAT Framework is expected to be made available shortly and is already being shared by some countries with business leaders in strategic economic sectors.

Based on the above developments, businesses should expect that VAT in the GCC region will be a reality from 1 January 2018. This means that businesses have only 10 months to prepare for VAT implementation and also ensure compliance with VAT laws in each GCC country in which they operate.
Detailed discussion

Preparing for VAT

EY’s experience with major companies in the region highlights an increasing level of concern that the lack currently of official guidance from government ministries is posing an increasing risk that the business sector will face significant challenges in preparing for VAT implementation by the proposed effective date.

The results of a recent survey of participants at EY webcasts on GCC VAT are concerning with 50% of the businesses surveyed reporting that they have not started any preparations. Only 11% of respondents reported that they have evaluated the changes that are needed to their financial, operational and information technology processes (enterprise resource planning (ERP) systems). Clearly, for many businesses in the GCC region the time to get started is now. Although communication about the timeline for VAT implementation and details of the Framework has been delayed, January 2018 is the stated target date and the underlying VAT principles are based on VAT regimes adopted in countries such as Singapore and Malaysia, and overlaid with European Union reverse charge principles to deal with intra-GCC trade. Any further delays in issuing country-specific VAT laws should not prevent companies from preparing for VAT in the GCC region.

Companies need to address contractual, financial and technology considerations well in advance of VAT introduction. VAT implementation challenges include:

- Finance and administration issues such as: cash flow, VAT refunds, input tax recovery, tax payments and accounting periods, imported services
- Information technology issues such as: system changes, system replacement, compliance, auditability, tax engines
- Procurement issues such as: multiple transaction types, vendor registrations, preferential treatment
- Business issues such as: business structure, efficiency, reputational risk, large number of stakeholders
- Human resources issues such as: fringe benefits, communication, staff education and training, policy and procedures
- Compliance issues such as: group registration, compliance, tax authority audits, quarterly VAT declarations
- Product offerings and marketing issues such as: pricing, contracts, competitor distortion

With 10 months to go before the GCC VAT is implemented, 51% of businesses reported that VAT compliance will be their main area of focus, while just 8% of respondents said they would be concerned about procurement considerations, and 10% reported they will look to address customer and vendor pricing as a priority. VAT will impact all key areas of business operations and it is imperative that businesses act immediately to avoid serious issues and costs.

Further, only 13% of businesses responded that they considered education and training of primary importance during VAT preparations. Global experience has shown that VAT training and education is fundamental to ensure successful VAT implementation.

Business focus should be primarily on system and business process readiness, communication, staff training, and sourcing VAT knowledge internally or externally. Compliance with the requirements of the VAT law will follow if these areas are properly addressed.

Over the year ahead, EY will continue with active seminars, webcasts and tax training programs to provide companies with the necessary, deep understanding required to successfully prepare for the imminent introduction of VAT in the GCC States.

Specific matters that require immediate attention

Companies need to be aware of the costs associated with the business changes required to successfully incorporate VAT into all their processes and make sure sufficient funding is budgeted for this purpose. Well-planned and effective change management will be critical to a company’s success in implementing VAT. Companies need to be concerned not just with their own readiness, but also that of suppliers and other external agencies – VAT is collected all along the supply chain and a failure along that chain will impact others. For many people who work and do business in the GCC region, VAT will be a new concept – a tax on consumption, not a sales tax, and it is critical that this is understood. Although it is the consumer who ultimately bears the tax, businesses will have the administrative responsibility of being the government’s VAT collection agent along the supply chain. This comes at a cost and exposure to penalty if not administered correctly.

Companies and traders who are consistently in a position of recovering VAT from the government – if they export or make zero-rated supplies – will need to factor in the potential negative cash flow impacts that their business will be exposed to as well as the likely additional scrutiny their books and records will be subject to by the tax authorities.
Business systems, from fully integrated ERP systems to stand-alone finance packages will often include standard VAT functionality. However, this is likely to require modification to capture specific GCC regulations. For larger organizations, configuring VAT in their ERP and finance systems will be resource intensive, potentially complex and expensive. Financial advisors, system specialists and solution providers are also likely to have resourcing issues, while attempting to support their customer base across the GCC region.

Finally, it was most surprising that over 62% of multinational companies reported that their head office or parent company was not involved or only partially involved in their efforts to prepare for and implement appropriate system, process and organizational changes to accommodate the VAT regime from 1 January 2018. With the potential impact VAT could have on cash flows and business profitability if preparations are not handled properly, the GCC branches and subsidiaries of multinational companies would be advised to ensure that their head office or parent company is well informed of the VAT developments, the likely consequences and the implementation measures that are necessary.

Key features of GCC VAT Framework

- The standard VAT rate will be 5% unless a zero rate or exemption applies
- The Member States have the right to subject the following sectors to a zero rate or exempt them from VAT:
  - Education
  - Health
  - Real estate
  - Local transport
- The Member States have the right to subject the oil sector, petroleum derivatives and gas to a zero rate of VAT
- Individual GCC countries have the right to subject certain food products to a zero rate of VAT
- The Member States have the right to subject medical supplies to a zero rate of VAT
- Intra-GCC and international transport will be subject to a zero rate of VAT
- The export of goods to jurisdictions outside of the GCC will be subject to a zero rate of VAT
- The Member States have the right to exempt financial services from VAT. The term financial services is not defined; but broadly, the exemption will relate to dealings in money, securities, foreign exchange, and the operation and management of loan accounts, deposits, trade credit facilities, and related intermediary services. The exemption is not expected to extend to fee-based services transacted by a financial institution. However, Member States may choose to apply different VAT treatments to financial services if they wish
- The insurance sector is not addressed specifically in the framework agreement; however, it is presumed that this falls under the reference to financial services in the agreement
- Supply of goods and services from a VAT-registered person in one Member State to a VAT-registered person in another is subject to reverse charge mechanism
- VAT grouping appears to be permitted between two or more legal persons resident in the same Member State
- The treatment of GCC free zones is not addressed and is left to each Member State to determine its own VAT treatment for free zones
- Businesses with an annual revenue exceeding US$100,000 or equivalent in the currency of the Member State will be required to register for VAT purposes
- Businesses with an annual revenue between US$50,000 and US$100,000 will have the option to register for VAT purposes

EY survey results

The EY survey, noted above, considered the response of over 500 participants representing businesses operating in the GCC region and the respondents gave inputs on three specific questions as outlined below:

- How prepared is your business for the VAT introduction on 1 January 2018?
  A. We have not started any preparations: 50%
  B. We have studied some of the new VAT provisions: 29%
  C. We have had a workshop with stakeholders: 6%
  D. We have conducted an impact study: 4%
  E. We have considered changes needed to our ERP system: 11%
On which area of your business are you most focused when preparing for the introduction of VAT?

A. Compliance: 51%
B. Procurement: 8%
C. Education and training: 13%
D. Customer and vendor pricing: 10%
E. ERP system readiness: 17%

How connected is your headquarters with your Middle East entities in preparation for January 2018?

A. No HQ visibility: 29%
B. Partial HQ visibility: 33%
C. Full HQ visibility; Middle East leading all activities: 16%
D. Full HQ visibility and involvement for enterprise changes (e.g., ERP); Middle East leading all other activities: 7%
E. Fully connected: 15%

Endnote
1. These features will apply to the adoption of the GCC VAT framework by all Member States.
For additional information with respect to this Alert, please contact the following:

Ernst & Young, Doha, Qatar
- Finbarr Sexton, EY MENA Indirect Tax Leader +974 4457 4200 finbarr.sexton@qa.ey.com
- Jennifer O’Sullivan, EY VAT Implementation Leader +974 4457 4116 jennifer.osullivan@qa.ey.com
- Filip Van Driessche +974 4457 4259 filip.vandriessche@qa.ey.com
- Andrew Vye +974 4457 4287 andrew.vye@qa.ey.com
- Deepak Divakaran +974 4457 4259 deepak.divakaran@qa.ey.com

Ernst & Young Middle East, Dubai Branch, United Arab Emirates
- David Stevens, EY VAT Implementation Leader +971 4 332 4000 david.stevens@ae.ey.com
- Nicola Butt +971 4 701 0853 nicola.butt@ae.ey.com
- Iliana Panova +971 4 701 0100 iliana.panova@ae.ey.com
- Sam Jong Lim +971 4 701 0100 hengjong.lim@ae.ey.com

Ernst & Young Middle East, Abu Dhabi Branch, United Arab Emirates
- Sana Azam +974 5 005 4085 sana.azam@ae.ey.com

Ernst & Young LLC, Muscat, Oman
- Ahmed Amor Al-Esry +968 24 559 502 ahmed.amor@om.ey.com
- Alkesh Joshi +968 24 559 558 alkesh.joshi@om.ey.com
- Mitul Patel +968 24 559 569 mitul.patel@om.ey.com

Ernst & Young, Manama, Bahrain
- Ivan Zoricic +973 1751 4768 ivan.zoricic@bh.ey.com
- Shankar P B +973 1751 4762 shankar.pb@bh.ey.com

Ernst & Young & Co (Public Accountants), Riyadh, Saudi Arabia
- Amr Farouk +966 11 215 9898 amr.farouk@sa.ey.com
- Ahmed Hassanin +966 11 273 4740 ahmed.hassanin@sa.ey.com
- Dino Savedra +966 11 215 9898 dino.saavedra@sa.ey.com
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