Executive summary

Saudi Arabia’s Tax Authority, General Authority of Zakat and Tax (GAZT), has released a draft bilingual version of the Value-added Tax (VAT) Implementing Regulations (the Bylaw) on its portal for public consultation. With the official publication of the finalized VAT law in the Saudi Gazette, businesses should be able to assess their operation and prepare for the implementation of VAT on 1 January 2018.

The scope of the standard rate VAT is wide and there are very few zero-rated or exempt items, as food, health, education and first sale of residential property are not zero-rated.

Detailed discussion

Key provisions

The key provisions of the Bylaw are:

Registration of small business units with GAZT - Small businesses with turnover below SAR1m (approx. US$267k) will be given an additional year to register with the GAZT, i.e., until 1 January 2019. This will enable smaller businesses to prepare and be VAT-ready.
The Bylaw sets out the mandatory electronic registration requirements which are expected to be open for VAT registrations from September 2017. This is notwithstanding that the GAZT have commenced the process for registering large businesses (revenues in excess of SAR40m) (approx. US$10.7m) and very large businesses (revenues in excess of SAR2b).

**VAT grouping** - If a group of companies’ share common control (ownership control) of more than 50%, they will be considered for VAT grouping. The VAT grouping provisions of the Bylaw includes an anti-avoidance measure, whereby a VAT group may be set aside or disallowed, if the main purpose of the group is to obtain a tax advantage. However, it will be difficult to reconcile this anti-avoidance measure with a taxpayer or group of taxpayers’ intentions regarding possible tax advantages. This is likely to give rise to potential tax litigation in the future.

**Financial services supply** - Financial services supplies, including Islamic finance products are exempt from VAT. Consideration received for services rendered by banks by way of explicit fees, commission or commercial discount, will be subject to VAT at the standard rate. Exempt financial services supplies may be summarized as follows:

- Interest or lending fees charged with an implicit margin for any form of lending, including loans and credit cards
- Interest or lending fees charged with an implicit margin for a mortgage or under a diminishing musharaka arrangement
- Interest or lending fees charged with an implicit margin for short term finance, including finance leasing, hire purchase products or under a murabaha contract
- Commissions charged on an implicit margin or spread for brokerage services, or under a mudaraba or wakala contract
- The issue or transfer of a debt security, equity security, or any other transferable document recognizing an obligation to pay a monetary amount to the bearer

In respect of insurance services, life insurance is exempt, whereas general insurance is subject to the standard VAT rate.

**Residential supplies** - Residential real estate leasing or licensing, (excluding hotels, inns, guesthouses, motels, serviced apartments or other temporary accommodation) are exempt from VAT.

**Medical supplies** - Qualifying medicines (list of medicines approved by the Ministry of Health) or medical goods (goods licensed by the Saudi Food and Drug Authority (SFDA)) dispensed to an individual for personal use on an authorized prescription is zero-rated, provided that such dispensing is carried out by a registered pharmacist, an SFDA-licensed distributor, a primary health care center or in a hospital.

Those supplies rendered earlier in the supply chain that do not adhere to these requirements will be taxable, i.e., only the supply to the individual recipient will be zero-rated or exempted.

**Government authorities** - Government authorities are not considered to be carrying on an economic activity and therefore not required to register for VAT. However, if they are involved in the supply of goods and services in competition with the private sector, they would be considered to be carrying on an economic activity. In such instances, they will be required to be registered for VAT, if they meet the threshold registration requirements. A government authority may apply for a certificate from the tax authority, which they can quote to the suppliers making the zero-rated supplies. Based on this, the government authority entity can also apply the reverse charge mechanism.

**Transfer of going-concern** - In the case of a going concern, when an economic activity is transferred, it will not be subject to VAT, provided certain conditions are satisfied. This is a positive development considering the fact that going concern transactions are among the most disputed transactions in other VAT jurisdictions.

**Reverse charge mechanism** - Taxpayers can adopt the reverse charge mechanism on the importation of goods into Saudi Arabia, provided the taxpayer has a proven track record as a compliant taxpayer for the previous 12 months.

**Method of VAT calculation** - Taxpayers supplying used motor vehicles can adopt the profit margin method of VAT calculation.

**Supply of vouchers** - Supplies of vouchers are not subject to VAT, where the consideration is equal to or less than the face value of the voucher.

**Input tax credits** - For acquisitions made up to six months before registration, special rules need to be applied for claiming input tax credits. Input tax credits cannot be deducted for:

- Entertainment, sporting or cultural events
- Catering services in hotels, restaurants and similar venues
- Purchase or lease of motor vehicles used or made available for private use (restricted motor vehicles) and any costs associated with restricted motor vehicles, any other private or non-business goods or services
Special rules apply for claiming input tax credits for acquisitions made up to six months before registration.

**Deduction methodology** - The proportional deduction for non-direct attributed acquisitions is based on the taxable sales of the previous calendar year divided by total sales for the same period. Capital assets are excluded from the above calculation. Adjustments need to be made in the final tax return when the actual amounts are known. Taxpayers may also apply for alternative methods. However, the *de minimus* rule is not available.

**Capital assets** - The adjustment period for deduction of input tax credits in relation to change in the use of capital assets is 6 years for tangible or intangible capital assets and 10 years in respect of immovable capital assets or the useful life of the capital asset where it is less than the 6 or 10 years. Such adjustments are required every 12 months.

**Tax invoices** - Tax invoices must be issued by the 15th day of the month following the month of taxable event. It is anticipated that this is likely to create problems when suppliers delay the issuance of tax invoices.

The VAT amount payable (in Saudi riyals) is required be shown in Arabic. The Tax Identification Number (TIN) of the customer need not be shown in the tax invoice. The simplified tax invoice requirements include stating the tax payable or the amount inclusive of tax.

**Debit and credit notes** - The requirements for debit and credit notes are detailed in the Bylaw. Debit and credit notes must include reference to the sequential number of the tax invoice.

**Details of the tax return** - A tax return should include the following details:
- Total value of taxable supplies and zero rated supplies
- Total acquisitions
- Total deductible input tax
- Total value of nominal supplies
- Total value of supplies subject to the reverse charge mechanism
- Total value of internal supplies
- Total tax on imports
- Total value of exempt supplies
- Other supplies
- Value of adjustments (proportional deduction of input tax)
- Adjustment made on the change of use of capital assets
- Corrections related to previous returns

It is likely that this extensive list of required disclosures will prove to be a challenge to incorporate or implement taking into consideration the required number of tax codes and general ledger codes.

**Amendment of tax return** - Errors greater than SAR5k (Approx. US$1.3k) requires the previous tax return to be amended. Where tax evasion or intentional breaching of provisions are found, the limitation period for amendment of assessment can range up to 20 years.

**Tax records** - Records must be kept for 6 years from the end of the tax period and in relation to capital assets, these must be maintained for a 6 or 10 year period as the case maybe, plus 5 years.

**Grandfathering provisions** - In case of grandfathering provisions for contracts, the customer must certify that they are able to claim the input tax in full. An application to the tax authority is not required in this respect and the regulation does not stipulate any minimum value for these contracts.

Note: The above comments are based on the draft version of the VAT Bylaw (based on unofficial translations) and likely to be subject to change.

**Next steps**

The GAZT is conducting various sessions to actively engage with business groups to increase awareness on the proposed VAT and its impact on their businesses. It is imperative for businesses operating in the Gulf Cooperation Council (GCC) region to take immediate steps to become compliant with the respective GCC Member State’s VAT laws.

GCC businesses should initiate a VAT impact assessment immediately in order to determine the impact of VAT across their operations. This assessment should consider the VAT impact on the following key areas:
- Finance and accounting IT and systems
- Tax and compliance
- Supply chain – goods and services
- Contracts
- Sales and marketing
- Legal structure
- Human resources

The impact assessment should be used to develop a clear plan detailing the steps that must be taken to be ready for the VAT go live date of 1 January 2018.
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EYG no. 04473-171Gbl
1S08-1600216 NY
ED None

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