Saudi Arabia releases draft IRs

1 August 2017, Kingdom of Bahrain

Saudi Arabia's General Authority of Zakat and Tax (GAZT) has released a draft bilingual version of its VAT implementing regulations. Businesses must now be actively preparing for VAT - 1 January 2018 is less than 100 working days away.

The scope of the standard VAT rate is broad. There are few zero-rated or exempt items. Food, healthcare, education and the first sale of residential property are all standard-rated.

Our analysis of the major talking points

Amendments to tax returns: Errors in a previous tax return valued at less than SAR5,000 can be corrected on the next tax return. In cases involving fraud, the tax authority has the power to assess up to 20 years retrospectively.

Capital assets: Taxpayers must monitor the taxable usage of tangible and intangible capital assets for a period of six years - or ten years for immovable capital assets. If taxable usage of these assets changes within the relevant period, taxpayers will be required to adjust the input tax initially claimed upon purchase or construction. These adjustments are required every 12 months.

Debit and credit notes: Debit and credit notes must contain a reference to the sequential number of the tax invoice.

Frequency of returns: Taxpayers whose turnover exceeds SAR40m will be required to submit monthly VAT returns. All other taxpayers will be required to submit on a quarterly basis. However, taxpayers can opt to pay on a monthly basis – which may benefit traders in a repayment position.

Deductions: The proportional deduction for residual input VAT is based on the taxable sales of the previous calendar year divided by total sales for the same period. Capital assets are excluded from this calculation. Adjustments need to be made once the actual amounts are known. Tax payers may also apply for alternative methods although the *de minimus* rule is not available.

Financial services: As expected, margin-based financial services will be treated as exempt. However, fixed fees, such as bank fees or commissions, will be subject to the standard VAT rate. Life insurance will be exempt but general insurance will be standard-rated. The VAT treatment of Islamic finance products will mirror the VAT treatment of equivalent conventional products.

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Government authorities: Because government authorities are generally not considered to be carrying on an economic activity, they are not required to register for VAT. However, if they are competing with the private sector, they are carrying on an economic activity and so will be required to be registered for VAT if they meet the threshold requirements.

Grandfathering provisions: The IRs allow zero-rating of supplies under contracts entered prior to 30 June 2017, up to the earlier of the time the contract expires or is renewed or 31 December 2022. An application to the tax authority is not required, however, the customer must have been entitled to recover input tax on the relevant supply, if charged, and must certify this to the supplier. The regulation does not stipulate any minimum value.

Input tax credits: Subject to certain conditions, VAT incurred by a business on the purchase of goods prior to registration may be recoverable. VAT incurred on the purchase of goods supplied within six months of the effective date of registration may also be recoverable.

Mandatory electronic registration requirements: The registration system is expected to be live from September 2017, although GAZT has already started registering large businesses (revenues in excess of SAR40m) and very large businesses (revenues in excess of SAR2b).

Medical supplies: Medicines from the list approved by the Ministry of Health or medical goods licensed by the Saudi Food and Drug Authority (SFDA) and dispensed to an individual for personal use on an authorized prescription are zero-rated, provided they are dispensed by a registered pharmacist. Medical supplies earlier in the supply chain that do not adhere to these requirements will be taxable.

Registration of small businesses with GAZT: Smaller businesses (turnover below SAR1m) will be given an additional year to register with GAZT. Delaying until 1 January 2019 should help smaller businesses to prepare better for VAT.

Residential supplies: Residential real estate leasing or licensing (excluding hotels, inns, guesthouses, motels, serviced apartments or any other temporary accommodation) are exempt from VAT. The sale of residential property will be subject to VAT.

Reverse charge for imports: The reverse charge mechanism will apply to imported services and goods and services acquired from other GCC states. In addition, as a concession, the reverse charge mechanism may be adopted (instead of import VAT), provided certain conditions are met.

Tax invoices: Tax invoices must be issued by the fifteenth day of the month following the month of the taxable supply. This may create problems if and when suppliers delay the issuance of tax invoices. The tax amount payable (in Saudi riyals) must be shown in Arabic. However, the tax identification number (TIN) of the customer need not be shown in the tax invoice. Simplified tax invoices may be issued for supplies less than SAR1,000.

Tax records: Records must be kept for six years from the end of the tax period. With capital assets, records may need to be maintained for up to 15 years.

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Tax returns: A tax return should include values in respect of:

- Taxable and zero-rated supplies
- Acquisitions
- Deductible input tax
- Nominal supplies
- Supplies subject to the reverse charge mechanism
- Internal supplies
- Taxes on imports
- Exempt supplies
- Other supplies
- Adjustments (proportional deductions of input tax)
- Adjustments to input tax in respect of capital assets
- Corrections related to previous returns

This may prove challenging, given the number of tax codes and general ledger codes involved.

Transfers of going concerns: Subject to meeting certain conditions, transfers of a going concern will not be subject to VAT.

VAT calculations on used motor vehicles: Provided certain conditions are met, taxpayers selling used cars can use the margin scheme to calculate VAT.

VAT grouping: Companies under common control can be considered for VAT grouping. The VAT grouping provisions contain an anti-avoidance measure setting aside VAT groups if the main purpose of the group is to obtain a tax advantage. In practice, it could be difficult to show a taxpayer or group of taxpayers are misusing the system to secure a possible tax advantage. This may lead to possible tax litigation in the future.

Vouchers: Supplies of vouchers are not subject to tax as long as the consideration is equal to or less than the face value of the voucher. However, a supply will be made when the voucher is redeemed.

Next steps

Any business operating in the GCC should immediately take steps to become compliant with local VAT legislation, by developing an understanding of the impact of VAT on:

- Pricing
- Profits
- Cash flow
- Finance processes and accounting
- IT systems
- Customers
- Suppliers
- Contracts

Important note

These highlights are based on a translation of Saudi Arabia's draft VAT laws and general VAT principles and are provided for information purposes only. This document is not a substitute for professional advice. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.

VAT briefs

We have developed a set of sector-focused briefing documents which explain many of the most important challenges that VAT will pose for GCC businesses. Sectors covered include:

- Automotive
- Education
- Financial services
- Healthcare
- Hospitality and tourism
- Insurance
- Islamic financial services
- Oil & gas
- Real estate & construction
- Retail
- Takaful
- Telecommunications, media & technology

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