VAT brief – Financial services

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keypoint

Following on from the release of the GCC VAT framework, Saudi Arabia's General Authority of Zakat and Tax (GAZT) has released a draft version of the law as well as a bilingual version of its VAT implementing regulations. All businesses must now be actively preparing for VAT - 1 January 2018 is less than 100 working days away.

What is VAT?

- VAT is a tax on consumption, not income or profits.
- The GCC countries have agreed a standard VAT rate of five percent.
- Goods and services can be exempt, zero-rated or standard-rated.
- Registered suppliers will add VAT to the price of a good or service they supply, collect the tax and pay it to the tax authority on a regular basis.
- Registered businesses should (where the supplies they make are either standard or zero-rated) be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are exempt from VAT will not be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are zero-rated will usually be in a refundable position.

How will VAT affect the financial services sector?

- Under the GCC framework, each GCC country has the right to exempt certain financial services. Neither the draft Saudi VAT law nor the VAT framework define financial services or financial supplies.
- Based on the draft VAT implementing regulations which have been released by Saudi Arabia's GAZT, margin-based products – such as interest on loans and foreign exchange transactions – are exempt from VAT.
- Fee-based services such as bank fees or commissions are subject to VAT at the standard rate (five percent).
- Financial institutions will be unable to recover VAT incurred in the course of producing exempt supplies, increasing their input cost.
- Restrictions on the recovery of input tax will affect the cost of some 'business as usual' practices such as property leases or the acquisition of services or office supplies and equipment. Financial institutions will face additional costs of up to five percent.
- Financial institutions will want to maximise the recovery of input tax credits, requiring them to carefully consider all the purchases of goods and services they make and determine how best to minimise input VAT they cannot claim.
- Financial institutions may ultimately decide to increase their charge to customers, but will need to be wary of regulatory constraints and the impact on their competitive advantage.
- VAT may create a significant commercial opportunity for banks as their clients are likely to have substantial new working capital requirements.

What should banks be doing now?

- Carefully review all supply activities to determine the appropriate VAT treatment and the scope of any exemptions.
- Consider the corresponding impact of exemptions and non-recoverable input taxes and the effect of VAT on pricing.

Important note

These briefs 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.

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