VAT brief | Automotive

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We have entered a new tax era. Saudi Arabia and the UAE implemented VAT on 1 January 2018. Bahrain implemented - for businesses with taxable turnovers above BD5m - on 1 January 2019 - with other businesses going live on 1 July 2019 or 1 January 2020. Other GCC countries are expected to follow. Key decision makers in the UAE, Saudi Arabia and Bahrain need to ensure their processes and systems are - and remain - VAT-compliant, while their peers in other GCC states need to start preparing now for VAT's implementation.

What is VAT?

- The GCC countries have agreed a standard VAT rate of five percent.
- Supplies of goods and services can be exempt, zero-rated or standard-rated (five percent), or out of scope.
- The mandatory registration threshold (MRT) is the equivalent of US$100,000. The voluntary registration threshold is the equivalent of US$50,000. Bahrain has staggered VAT's introduction.
- Registered businesses account for VAT - a consumption tax - on the price charged for the goods or services they supply and regularly pay the VAT to the tax authority.
- Where registered businesses make supplies that are standard- or zero-rated or out of scope with recovery, they should be able to recover the VAT they have incurred in making those supplies.
- Registered businesses making supplies that are exempt from VAT cannot recover the VAT they have incurred in the course of making those supplies.
- Registered businesses may be unable to recover VAT incurred on purchases that are deemed to have a private element.
- Registered businesses making supplies that are predominantly zero-rated are likely to be in a VAT refund position.
- Businesses that make both exempt and taxable supplies can only recover a proportion of their input VAT.

How does VAT affect businesses in the automotive sector?

- Most supplies made by auto dealers – such as the sale of cars, parts and repair services – are standard-rated.
- However, auto dealers also make other supplies. Certain financial services in relation to auto loans and credit are likely to be exempt from VAT.
- When providing finance, the appropriate VAT treatment will need to be considered:
  - Is there an operating or finance lease?
  - Is the dealer acting as an intermediary or directly providing financing?
- Auto dealers leasing cars generally account for VAT on the principal element of lease payments. Issues may arise where the finance element is not disclosed. Supplies made under contracts that span the VAT implementation date (such as in lease-to-own or instalment payments) may be subject to special rules which determine when VAT is applied.
- Special rules may apply for second-hand cars, where VAT is only charged on the profit margin. The UAE, Saudi and Bahraini laws allow VAT to be applied only on the profit margin of eligible used goods. In Saudi Arabia and Bahrain, permission is required from the tax authority before this can be used.

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- The VAT treatment of demonstrator, employee and courtesy cars must be carefully considered as any element of private use will rule out the recovery of VAT incurred when bought.
- Dealers should consider the VAT treatment of any bonus or promotional payments received from manufacturers.
- When importing vehicles, keep customs documentation in order. When exporting vehicles, consider whether zero-rating requirements are satisfied, particularly when selling to customers resident in other GCC countries – you should assess (among other things) whether the vehicle will be shipped within 90 days of sale and whether the vehicle will be 'changed' or 'used' before leaving the country.
- Cars sold prior to the introduction of VAT but delivered to customers after VAT may still attract VAT.

What should automotive businesses be doing now?

All dealers should:

- Consider pricing and its impact on demand
- Examine sales and accounting processes to ensure the correct VAT treatment is being applied
- Evaluate the impact of time of supply rules on deposits, warranties and service contracts
- Apply to use the second-hand profit margin scheme
- As specific time of supply rules apply, review different types of finance arrangements - including rentals and operating and finance leases - to determine the impact VAT on customers and when to account for VAT

Dealers yet to register for VAT should:

- Undertake a VAT readiness check and update systems accordingly
- Evaluate stock levels to deal with fluctuations before and after VAT implementation
- Review leasing contracts to confirm whether VAT can be charged following implementation - or whether transitional provisions apply
- Examine any long-term contracts spanning the date of implementation and decide whether VAT can - or should - be charged to customers