VAT brief | Financial services

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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 financial services sector?

- Under the GCC framework, each GCC country can choose to exempt financial services.
- The UAE, Saudi Arabia and Bahrain have exempted margin-based financial services (such as interest revenues, or the margins made from currency exchange) from VAT. In Bahrain, interest income on bank deposits is generally out of scope.
- A number of other 'business as usual' activities have also been exempted from VAT, including:
  - The issue, transfer or receipt of, or any dealing with, money, any security for money, or any note or order for the payment of money
  - The provision of any credit or credit guarantee
  - The operation of any current, deposit or savings account
  - Financial instruments such as derivatives, options swaps, credit default swaps and futures
- Fee-based services such as bank fees or commissions are subject to VAT at five percent.
- Financial institutions will be unable to recover VAT incurred in the course of making exempt supplies, with non-recoverable VAT on expenses becoming a cost to the business.

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- Not all expenses can be directly attributed to taxable or exempt business activities. As a result, VAT rules provide for apportionment calculations, annual wash-up (or balancing) adjustments and tracking rules for capital assets – adding complexity to VAT profiles.
- The UAE requires an annual 'fair and reasonable' assessment of the proportional recovery achieved.
- Financial institutions will want to maximise the recovery of input tax, requiring them to carefully consider any purchases and how best to maximise input VAT they can recover.
- Financial institutions may ultimately decide to pass on additional costs by increasing fees, but will need to be wary of regulatory constraints and the impact pricing may have on their competitiveness or market share.
- The introduction of VAT may create a significant commercial opportunity for banks as their clients are likely to have substantial new working capital requirements.

What should businesses in the financial services sector be doing now?

- Review all supply activities to determine VAT treatments and the scope of any exemptions.
- Consider the impact that non-recoverable VAT will have on costs and whether these additional business costs will be reflected in pricing structures.
- Assess whether the VAT apportionment method is fair and reasonable or whether recovery can be improved by use of other methods.
- Examine any long-term contracts spanning the date of implementation and determine whether VAT can - or should - be charged to customers.