VAT brief | Oil & gas

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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 oil and gas sector?

- The UAE and Bahrain have zero-rated the supply of crude oil and natural gas, with Bahrain extending the zero-rating provision to also include any oil, oil derivatives and gas (whether processed or unprocessed).
- Suppliers of oil & gas products are likely to almost always be in a VAT refund position, as their primary sources of revenue are zero-rated and they should be entitled to full recovery of VAT incurred on their costs.
- As the Saudi rules are silent on relief for the oil & gas sector, supplies of crude oil and natural gas are taxable at five percent.
- Determination of place of supply can be complicated for the sector as activities take place - for VAT purposes - both onshore and offshore and there can be multiple imports and exports - sometimes on a temporary basis - in supply chains.
- Where the supply of oil and gas is taxable at 5%, the timing of VAT accounting could significantly impact cash-flow. Typically, VAT is accounted for at the earlier of the supply being made, payment being received, or invoice being issued. Depending on payment terms and when the time of supply is triggered, output VAT may be payable to the tax authorities before payment is received from a customer.

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- The UAE, Saudi Arabia and Bahrain rules have special transitional relief provisions for contracts which span implementation. The other GCC states may enact similar provisions for long-term contracts. Businesses wishing to rely on such provisions need to ensure they meet all of the criteria before doing so.
- Consistent with general VAT principles, exports to outside the GCC are zero-rated.
- Cash-flow and the time-frames for obtaining VAT refunds are likely to be the single biggest issue for oil & gas businesses as they incur VAT on most of their expenses, but a large proportion of their sales are likely to be zero-rated (either because sales are zero-rated (for UAE & Bahrain suppliers) or because they are zero-rated as exports).
- VAT incurred on capital expenditure significantly impacts cash-flow. Large-scale capital expenditure is often incurred at the early stages of an oil & gas project while supplies (income flow) are likely to occur some years later. Depending on the turnaround time for tax authorities to process and approve VAT refunds, business may be left waiting for VAT refunds.

What should businesses in the oil & gas sector be doing now?

- Long-term contracts that span the VAT implementation date should be reviewed to ensure the supplier has the contractual right to charge the VAT amount in addition to the contract price (rather than accounting for VAT within the price).
- Consider the impact of place of supply rules, particularly for any offshore drilling and production activities and imports and exports.
- Examine the impact of VAT incurred on cash-flow - particularly if you expect to be in a refund position.
- Decide whether VAT can - or should - be charged to customers.