



GCC Value-Added Tax (VAT)

Analysis of the GCC VAT
Framework Agreement



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"The GCC framework agreement provides clarity for companies and is the cornerstone for the content for the local legislations. Companies can and should now embark towards implementation of VAT in 2018."

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Analysis of the GCC VAT Framework Agreement



The Gulf region (including the Kingdom of Bahrain), has long been considered an attractive and low-tax environment. However, to keep up with the changing economic landscape and as part of wider development reforms, the Gulf Cooperation Council (GCC) member states signed a framework agreement to introduce Value-Added Tax (VAT) on the supply of goods and services at a standard rate of 5%, in 2018.

Implementing VAT will have implications for businesses and new taxpayers, both in Bahrain and abroad, directly and/or indirectly.

However, a broad-based VAT at a low rate is unlikely to deter investment into Bahrain, or the surrounding region, whose appeal stretches much further than its low-tax status.

Infrastructure development, access to high-potential growth markets in Africa and Asia, free-trade zones, competitive labor costs, few trade barriers and economic and political stability are all factors which add to the region's appeal. In addition, VAT will have a neutral impact on registered businesses when managed efficiently.

In this publication, KPMG examines the Unified Agreement for VAT of the Cooperation Council for the Arab States of the Gulf, the GCC VAT Framework Agreement, and analyzes the implications on businesses across the main economic sectors. We also outline practical steps businesses can take today, to be VAT ready and minimize as well as optimize the impact of VAT on their operations.

Background

The Unified Agreement for VAT of the Cooperation Council for the Arab States of the Gulf, sets out the framework under which VAT can be implemented in each of the GCC member states. The framework includes agreement on certain matters and in addition, requires member states to mandatory implement local legislation whilst allowing discretion on how to handle other related issues.

Once the agreement is ratified, each member state must integrate the framework into local law and implement VAT. Bahrain has announced the introduction of VAT by mid-2018, while some member states have indicated an intention to implement VAT from 1 January 2018. The framework allows for a basic rate of VAT on supplies of goods and services of 5%, as well as allowing such supplies to be zero-rated or VAT exempt depending ultimately on the domestic legislation of each country.



GCC countries

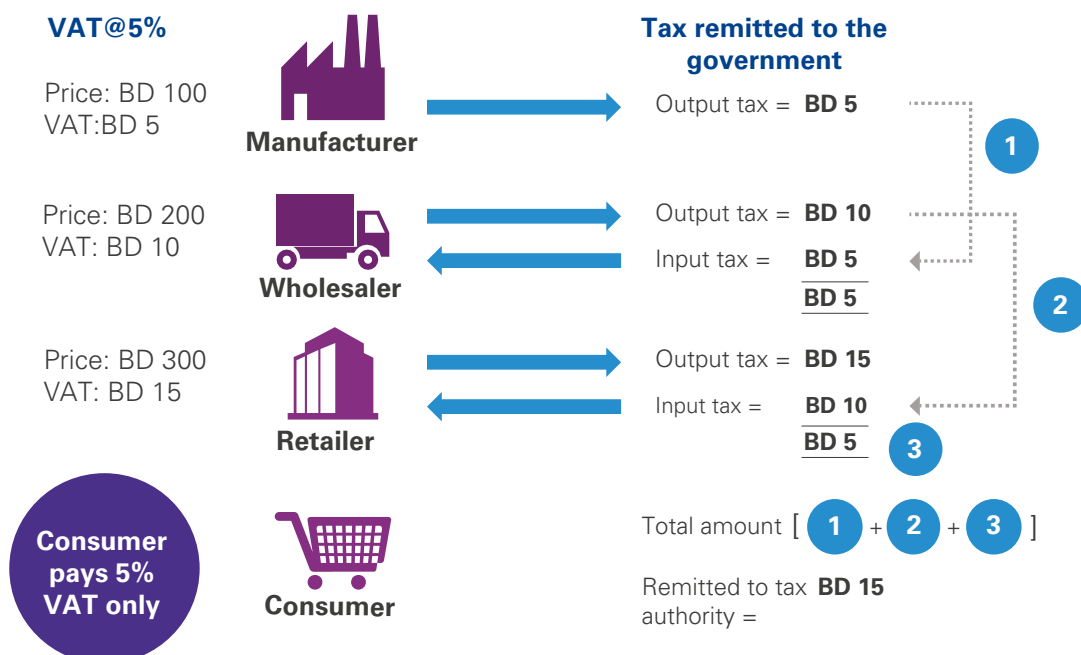
-  United Arab Emirates
-  Kingdom of Bahrain
-  Kingdom of Saudi Arabia
-  Sultanate of Oman
-  State of Qatar
-  State of Kuwait

What is VAT?

VAT is a tax on the consumption of goods and services. It is charged and collected by a taxable person and remitted to the tax authority. A taxable person, being a natural or legal person, is a person(s), who carries out economic activity that requires them to be VAT registered.

How will VAT work?

VAT will be calculated based on the consumption of goods and services. Businesses can claim credit for VAT paid on their business-related expenditures, as illustrated in the infographic below.



The GCC VAT Framework Agreement



What does the VAT Framework Agreement cover?

The VAT framework comprises of 15 chapters and 79 articles. These include:

- definitions and general principles including the scope of tax
- supplies within the scope of tax, including supplies of goods and services and deemed supplies
- place of supply of goods and services, including special cases
- importation
- due-dates and calculation of taxable values
- provision for exempt and zero-rate supplies
- liability to pay VAT
- deduction of VAT
- VAT registration obligations
- tax invoice (hereinafter "VAT invoice") and retention of records
- VAT return completion and filing requirements
- settlement or refunds of tax
- intra-GCC arrangements.

Who will the law apply to?

VAT will ultimately impact every business that supplies goods or services in the GCC countries. In particular, businesses that make taxable supplies over the mandatory threshold, must

register with the relevant tax authority. There is scope for voluntary registrations and VAT registration requirements will apply to non-resident entities. Additionally, there is scope to register multiple entities as a single VAT group, subject to conditions to be set out in the domestic legislation of each GCC country.

What is the place of supply?

VAT will vary depending on the local VAT regulations for each member state, according to the place of supply. The place of supply of goods is where the goods are disposed of or used by the customer. The place of supply of goods provided with transport is the place where the transport starts.

Special provisions for the place of supply of the following:

- oil, gas, water and electricity
- hiring means of transport, transport services for goods and passengers
- services to real estate properties
- supply of telecommunication and electronically provided services
- supply of restaurant, leisure, cultural and sporting events.

However, there are special rules which transfer the place of supply of goods with transport to the customer if they are a VAT registered entity in another member state. For services, the place of supply is where the supplier is resident.

However, the place of supply of services provided to a taxable customer shifts to where the customer is established.

What are taxable supplies?

Taxable supplies include all supplies of goods and services and transactions that are deemed to be such supplies (for example, transfers of stock abroad) and either subject to the 5% VAT rate, zero-rated or exempt. This includes:

- all goods or services (sales, transfers of ownership, disposals, leases, rentals and construction) used in business
- transfers of goods and services from and to other GCC countries
- transfers of goods and services from and to the rest of the world (outside the GCC)
- deemed supplies
- import of goods and most services.

What could be VAT zero-rated or exempt?

Zero-rated supplies

- medicines and medical supplies (common list to be determined by the Committee of Health Ministers)
- basic food items (common list to be ratified

- across the GCC)
- oil sector (at the discretion of the member state)
- international and intra-GCC transport
- transport (at the discretion of the member state)
- supply outside the GCC (for example, exports)
- supply of investment gold, silver and platinum.

VAT exempt supplies

Financial services carried out by authorized banks and financial institutions will generally be VAT exempt. Exempt services are not taxable supplies and therefore supplies made a taxable person making exempt supplies would not be able to recover any input VAT incurred.

Financial institutions may however be afforded the right to a refund of input tax, based on refund rates determined at the discretion of each member state.

Member states also have the discretion to apply any other tax treatment to the financial services sector.

Additionally, member states can choose to zero-rate or exempt the following sectors:

- education
- medical
- real estate
- local transport.





What are the consequences of making something VAT exempt or zero-rated?

Zero-rate VAT is still a rate of tax for a taxable supply. Consequently, a supplier of zero-rated goods or services is entitled to a credit for the VAT incurred on costs. In contrast, VAT exempt is not a rate of tax and is not a taxable supply. Those taxable persons making VAT exempt supplies may not claim credits on the VAT incurred on their costs. This results in a higher cost for VAT exempt suppliers.

Imports and exports

Imports refer to goods entering the GCC countries from outside the Gulf region. VAT is typically due on imported goods, however there are special rules regarding the valuation of imported goods and goods under suspension (as per Customs regulations).

Exports refer to goods transported outside of the GCC. Exports are typically zero-rated, subject to certain conditions.

When is VAT due?

There are some special rules, but generally, the time of supply for VAT purposes is the earlier of the:

- supply of goods or services
- issuance of a tax invoice
- receipt of partial or full payment.

How VAT will be deducted

A taxable person will be entitled to deduct the VAT amount incurred (input tax) in carrying out their taxable supplies from the VAT due on the taxable supplies made (output tax). Evidence of VAT charged and paid must always be available, typically a tax invoice. Each member state will adopt its own conditions for VAT deduction.

VAT is a tax on the consumption of goods and services paid by the end user.

What are the VAT invoice and retention of records requirements?

VAT invoices and accounting records must be kept for no less than 5 years from the end of the year the invoice was issued. For real estate properties, the VAT invoices and accounting records must be kept for 15 years.

What are the VAT return completion and filing requirements?

The minimum VAT period is 1 month, however, each member state has the discretion to extend the VAT period accordingly to the local VAT legislation.

Will there be special treatment of VAT for specific categories of persons?

The Framework Agreement caters for special VAT treatment to certain categories of person, where tax exemption will apply, or a refund of tax paid upon incurring tax for the following persons:

- government organizations
- charitable organizations and public utility establishments
- exempt companies by virtue of agreements for hosting international events
- citizens of a member state upon building their homes for personal use
- farmers and fishermen not registered for tax.

Who is responsible to administer VAT?

The Minister of Finance in the Kingdom of Bahrain has announced the plan to establish a tax authority to administer VAT.

Is there a threshold to register for VAT?

A taxable person shall be required to register for VAT purposes in the Kingdom of Bahrain if the annual value of supplies, exceeds, or is expected to exceed, the mandatory registered threshold of BD 37,700.



Transitioning to VAT

The Framework Agreement provides sufficient information for businesses to begin planning for VAT. With introduction in some member states just months away, businesses should start planning today to be VAT ready, following these key steps in respect of their business operations:

- 1** Identifying how VAT will impact the business model and operations. A line-by-line analysis of the business areas that are likely to be affected by the regulations, either directly or indirectly.
- 2** Analyzing the impact of VAT on the prices of services/products the business offers. Will VAT result in increasing demand, if prices are to rise? How will VAT affect businesses pricing strategy? Will there be an impact on business customers in the same way as individual customers?
- 3** Investigating whether current systems can support VAT. Do current IT and accounting systems recognize input taxes and enable them to be claimed on purchases that a business makes? Will the business be able to obtain the equipment and information necessary to issue special VAT invoices and, if so, what measures are required to control issues related to special VAT invoices?
- 4** Checking whether the business is entering into new contracts now, which can potentially span the introduction of the regulation. If so, are there contractual provisions within those contracts, which would allow the business to pass on the impact of a new tax? If the business is entering into contracts with suppliers to purchase goods or services, does the contract enable suppliers to pass on the impact of the tax to the businesses? What about existing contracts, are there any transition periods?
- 5** Examining the impact of VAT on cash flow. How does the business ensure it receives payments from customers before it is required to remit VAT and, equally minimize the timeframe between paying VAT on purchases and claiming input VAT credits?

How KPMG can help

Understanding and preparing for VAT is essential to ensuring that businesses are not exposed to financial or regulatory risk, as a result of the tax being implemented. Our Tax professionals are ready to help clients over the coming months to ensure that their transition to VAT is smooth and efficient, from planning to implementation and beyond. We have identified three core areas where our specialists can support clients:

- **Consulting:** Our indirect Tax professionals based in Bahrain, together with our international offices, are able to assist clients with any question relating to the upcoming changes; including, but not limited to: nexus study, taxability review, supply chain analysis, and review of compliance requirements.
- **Compliance:** Our local Centre of Excellence for VAT compliance will be able to assist clients with the preparation and filing of the new VAT returns. This could also take the form of on-site assistance or other types of co-sourcing.
- **Technology implementation:** Our Transactions Tax Systems team can assist clients that are implementing automated solutions to their transaction tax compliance processes.

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