

Value Added Tax (VAT) is coming soon to all the member states of the Gulf Cooperation Council (GCC).

Representatives of each member state of the GCC signed a VAT Framework Treaty (the VAT Framework) in October 2016.

Although the VAT Framework will form the basis for the domestic VAT legislation in each GCC member state, it is likely that there will be variations in the way it is implemented and applied in each.

No domestic legislation has yet been published.

Why Is VAT Being Introduced in the GCC?

GCC member states are introducing VAT:

- As an alternative revenue stream to maintain their levels of economic growth and public services
- To reduce reliance on increasingly unreliable revenues from hydrocarbons

When Is VAT Being Introduced?

The official implementation date for VAT systems across the GCC is set for 1 January 2018.

Although there remains uncertainty about whether all the Member States will be ready at the beginning of 2018, time is already short. To avoid compliance errors and maintain expected economic returns from carrying on business, firms should already be well advanced in their preparations. Before the implementation date, as well as having registered for VAT and established compliance systems, businesses in the GCC will need to:

- Review their existing, current and future contractual documentation
- Review their group structures
- Establish robust systems to be able to identify complex issues that may arise from time to time

VAT is a self-assessed tax but will be accompanied by rules imposing interest and penalties on errors and/or the late filing of returns and any failure to account on time or correctly calculate VAT.

What Is VAT?

VAT is an *indirect* tax (that is, it is collected on behalf of a tax authority by an intermediary). This makes VAT efficient: it is relatively cheap to collect and accelerates the point at which the tax authority receives the revenue. It has been implemented (in different forms) in over 150 countries.

VAT is a type of consumption tax. It is designed to be borne by the ultimate consumer but is charged, by reference to the price paid, at each stage of a supply chain. It will be applied to supplies of the majority of goods and services.

The practical effect is that taxable companies will need to:

- **Pay** VAT (input VAT) on taxable supplies that they receive
- **Charge** VAT (output VAT) on taxable supplies that they make
- **Account** for the output VAT they have collected (net of an allowable proportion (if any) of input VAT already paid) to the relevant tax authority

Who Will VAT Affect?

Only companies with annual revenues in excess of a certain minimum threshold will need to register for VAT. This will exclude some smaller companies, but such revenue thresholds are set relatively low. Voluntary registration will also normally be possible.

In the GCC, VAT is likely to have a material impact across a number of economically significant sectors including, for example:

- Real estate and construction
- Retail
- Financial services and insurance
- Oil and gas
- Tourism and aviation
- Technology, Media and Telecommunications

VAT will also affect governments and government-owned entities and businesses that transact with them. Governments and government-owned entities will need to determine whether, and to what extent, they need to charge VAT on supplies that they make. Businesses will need to determine to what extent they need to charge VAT on supplies made to governments and government-owned entities.

What Will the Rate of VAT Be?

• Standard rated

Applies to the majority of supplies; the initial standard rate is expected to be relatively low at 5%. It is widely expected, however, that the rate will rise in the next five years.

• Zero rated

Certain supplies will be mandatorily zero rated including, for example, the supply of medicines.

Zero-rated goods and services are taxable but at a rate of 0%. This means a supplier making zero-rated supplies is able to recover the input VAT incurred in respect of those supplies.

• Exempt

Certain supplies will be mandatorily exempt from VAT including, for example, the supply of most financial services.

A supplier making exempt supplies is generally not permitted to recover input VAT in relation to such supplies. This makes the VAT they incur on supplies a real cost of doing business.

In addition, it is understood that GCC Member States will be granted a degree of flexibility in determining other types of goods or services that should be zero-rated or exempt. It is in this respect that domestic regimes across the GCC will likely diverge most markedly.

What Are the Implications of VAT Being Introduced in the GCC?

At a theoretical level, VAT is based on relatively simple principles. In practice, however, VAT can lead to extremely difficult and complex issues, and there has been decades of substantial litigation in virtually all countries that have introduced it.

VAT also has a wide application – it impacts most commercial transactions and is something that will be necessary to consider in most transactions and in any structuring or restructuring.

Areas likely to be particularly difficult initially (either individually or in combination) include:

- Whether there has been a supply for VAT purposes
- The value of a supply
- Identifying when a supply is made (i.e. the time of supply)
- Identifying where a supply is made (i.e. the place of supply)
- Correctly determining the nature of a supply (and applying the correct rate)
- Maximising input VAT recovery
- Correctly analysing mixed and composite supplies (i.e. where a supply of one thing is made in conjunction with another)
- Tripartite supplies (i.e. where a supply is made to one party but a third party pays for it)
- VAT groupings
- VAT records (e.g. the issue of a proper invoice)
- Cross-border transactions

It is possible that any one of these areas could result in difficulty or even dispute with either:

- A contractual counterparty
- A tax authority

It will, therefore, be critical that businesses fully understand the implications of VAT being introduced in the GCC. They will need assistance:

- Understanding the basics of how the tax operates
- Understanding their likely compliance obligations under the new regime

- Establishing “best practice” systems and processes in order to minimise the disruption of operating VAT
- Ensuring their business structures and groupings are efficient for VAT purposes
- Reviewing their existing (and new) commercial contracts to ensure they provide appropriate VAT protections
- Receiving sector-specific guidance (including, in particular, clients operating in the sectors of real estate and construction, retail, financial services and insurance, oil and gas, tourism and aviation and technology, media and telecommunications)

What is clear from the case law in a number of jurisdictions is that courts will generally use the legal contract, rather than the economic substance of an arrangement, as a key starting point for their analysis. It will often be possible to achieve a better VAT result through appropriate drafting in a contract, or achieve a worse result by focusing on non-contractual aspects of VAT.

What Is Our VAT Expertise?

VAT is a long-established tax across the European Union. As a firm with strong representation across Europe, we are highly experienced in dealing with all aspects of VAT, technical, transactional and disputes, across the industrial sectors that will be most directly affected by the implementation of VAT.

The co-heads of our Gulf VAT team are Jeremy Cape and Lindsay Fainé. Jeremy is based in our London office, although he regularly travels to the Gulf region to assist clients on tax issues, and has 18 years of experience advising on domestic and cross-border VAT matters in a number of jurisdictions. Lindsay is based in our Abu Dhabi office and has 12 years of advising clients in the Gulf on tax issues.

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