Transition into the GCC's new VAT era.

10 GCC VAT questions you need to know.

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The introduction of Value Added Tax (VAT) is a paradigm shift for countries and companies based in the Middle East. On the 2nd of March 2017, Bahrain announced it will be introducing VAT on the 1st of January 2018, following similar announcements made by Saudi Arabia, United Arab Emirates and Oman earlier this year and in 2016. The impending deadline of 2018 gives companies less than 12 months to get ready for a new tax system which impacts every stage of a company's supply chain. Companies therefore need to consider policy, risk, operational and IT elements to become VAT compliant by 2018.

Pierre Arman, Market Development Leader for Thomson Reuters in MENA, answers some frequently asked questions about the introduction of VAT in the GCC – advising companies on the steps they can take to overcome challenges, as well as explaining the consequences of not being ready.

1. Where is VAT applicable? Are there any exemptions?

VAT is a broad-based consumption tax, which means that it covers a wide range of goods and services in its tax net and the burden of this tax is borne by the end consumer. VAT is also an indirect tax in that it is remitted to the government by companies even though the government is not taxing companies, but the actual end consumers. This is in contrast with direct tax, such as income tax, where the individual remitting tax to the government is the same individual that the government wants to tax.

Each country typically has its own specifications about what is taxable under VAT and we are still waiting to see what the VAT laws for the different countries in the GCC will dictate. However, a general trend worldwide is for certain products such as luxury goods (cars, perfumes and so forth) to be taxable under VAT, while basic food elements and services such as education, healthcare and the provision of utilities (such as water, electricity) are usually either exempt or zero rated.

2. Companies in the GCC are being advised to “take action” now to prepare for the introduction of VAT. What should their first step be?

First and foremost, every company should engage with their tax advisor(s). Before organizations can plan for VAT, they need to understand its potential impact on their business. Companies need to gain insight into the tax treatment of all their transactions and identify the gaps between where they are now and where they need to be when VAT is introduced in the region.

3. In practical terms, what are the compliance requirements under VAT for companies?

At a very high level, organizations need to be able to track and record VAT on every single transaction they undertake as a business, to show how much VAT they either collected or paid at a transactional level. At the end of the period, which can be on a monthly, quarterly or even on an annual basis (typically for very small businesses), they summarize this information into a VAT return. This then needs to be filed into the relevant government portal (or in some countries, in paper form). To achieve this goal and be fully compliant under VAT, a company needs to design a VAT policy, understand its risk profile, implement a compliance strategy & operational process, and finally review its IT systems currently in place.

It's also always good to remember that VAT is a self-assessed tax. This means the government's main interest is in the VAT return filed – the business is responsible for determining its own VAT liability. However, this also means that should the tax authorities challenge a company on a particular VAT return and this company is unable to justify certain key figures because their compliance processes are not robust enough, it can become challenging to defend itself. This will not be a pleasant position to be in.

4. How can companies ensure that their newly-developed tax strategies are compliant with the VAT law?

The only sensible option here is to work with a tax advisor who has the dedicated VAT expertise available to help a company understand how VAT might impact its business, as well as provide advice on how it can reduce its liability. This way, a company knows that its tax strategy and its VAT policy, procedures and controls have been reviewed and approved by a competent and independent party.

5. What are some of the challenges currently faced by companies in the GCC as they prepare for VAT; and which areas should they invest in to ensure a smooth transition?

One of the most striking challenges I've seen from talking to clients in the region, is the lack of knowledgeable resources. Essentially, companies are faced with three options when it comes to dealing with VAT:

1. Internal: A company has enough knowledge and skills to implement VAT, which means it has the capacity to set up a VAT compliance function internally.
2. External: A company wants to follow a pure outsourcing model for VAT reporting, using the services of a tax advisor.
3. Co-source: A company establishes a VAT function internally, but still requires a tax advisor to run certain processes or functions on its behalf.

Businesses should set aside enough time now to gain a thorough understanding of which option suits their organization best, as this will dictate future investments and resource allocations.

The other challenge that I'm often seeing in countries like Saudi Arabia is the current IT landscape within companies which is very often a combination of a branded Enterprise Resources Planning (ERP) system and Legacy systems or in-house built systems. Companies therefore need to understand which of these systems will be impacted by VAT, how to modify them and more importantly how to maintain them in the future as VAT legislations change all the time.

6. What are the implications for businesses that are not ready for VAT by the beginning of 2018?

The implications can be profound. Not being sufficiently prepared to manage VAT by 2018 could see companies failing to comply with the VAT law of the country in which they operate. This could expose these organizations to fines and other enforcement measures, depending on the final version of the law. That said, some analysts expect tax authorities to be lenient on companies for the first few returns, due to the steep learning curve that they face. I would personally highly recommend avoiding counting on any grace period from tax authorities in the region – it's always better to be safe than sorry.

7. How will VAT impact GDP growth and inflation, as well as investment behavior in the Middle East?

I strongly believe that VAT is a great opportunity for this region, as it will provide governments with a consistent source of revenue that can help them to diversify their economies from a commodity based model, in this case, mainly oil. If you also look at the economic impact, VAT is probably one of the least harmful taxes, due to the fact that it is – in theory – cost-neutral for businesses (if managed correctly). A study by a recruitment firm even claims it will be the biggest job creation driver in 2017 in the GCC.

Only time will tell how VAT will truly impact the economy in the GCC but any investors should see the GCC's VAT introduction as a sign of stability and willingness to change, reducing their reliance on a commodity-centric economic model, which can be extremely volatile as we have witnessed in recent years.

8. What are the potential factors that determine the success of the implementation of VAT?

It's always difficult to determine the success of such initiatives because it's challenging to measure success itself. However, one aspect that is easy to evaluate is how VAT is a duty on both sides of the equation. On one hand, governments must issue clear guidance for companies on what their VAT compliance responsibilities are and how they should meet them. Governments should also ensure a timely refund system, so that companies do not suffer unnecessarily from cashflow challenges. VAT is not a cost to a company, yet a business could find itself out of pocket while waiting for a refund after paying more VAT in supplies than it collected from sales. On the other hand, companies must spend enough time with their advisors to understand how VAT will impact them and implement the right policies, procedures and systems to ensure full compliance.

9. What can be learned from the VAT experiences in other Arab countries, such as Egypt?

One of the main lessons we have learned from VAT introduction initiatives worldwide is that they generate a substantial revenue stream for governments. At the same time, VAT represents a paradigm shift for companies who must devote more resources towards VAT management and compliance, and adjust their processes and infrastructures accordingly. If we take Egypt as a recent example, a lesson to be learned from there is the importance of clearly communicating major legislative change in advance to the market. Egypt introduced VAT on the 8th of September 2016 and to date, the business community is still unclear on certain aspects of the law, due to the fact that the VAT executive regulation has not yet been published. The last thing you want as a government is to put companies at risk of non-compliance because they are not aware of or do not understand the new tax legislation.

10. Which sectors will be most affected by the introduction of VAT and why?

All sectors will be affected by VAT. Whether you are caught in the VAT net or branded an exempt, zero rated or out-of-scope industry (still to be defined in the incoming legislation), VAT will impact all industries and all departments within organizations. People tend to view VAT as a problem for the finance department to solve. However, this could not be further away from the truth. All departments will feel the ripple effects – from operations to human resources. Industries are in the same boat; from financial services and education through to retail and luxury, every sector will be impacted. As such, all businesses should act now to understand how VAT will affect them and should start getting ready for it. The old adage "failing to plan is planning to fail" has never been so true.

How can Thomson Reuters help your business with the transition into the GCC's new VAT era?

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