VAT brief | Retail

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Saudi Arabia and the UAE implemented VAT on 1 January 2018, with the other GCC countries expected to follow in the next 12 months. Business leaders should now be more aware than ever that we are entering into a new tax era. Key decision makers in the UAE and Saudi Arabia need to ensure their processes and systems are - and remain - VAT-compliant, while their counterparts in the other GCC states need to start preparing now for the implementation of VAT.

What is VAT?

- VAT is a tax on consumption, not income or profits.
- The GCC countries have agreed a standard VAT rate of five percent.
- The supply of goods and services can be exempt, zero-rated or standard-rated (five percent), or out of scope.
- Registered businesses account for VAT on the price charged for the goods or services they supply and pay it to the tax authority on a regular basis.
- Registered businesses should (where the supplies they make are either standard- or zero-rated or out of scope with recovery) be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are exempt from VAT cannot recover the VAT they have incurred in the course of making those supplies.
- Registered businesses may not be able to recover the VAT they have incurred on certain purchases that are deemed to have a private element.
- Registered businesses that make 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 will VAT affect the retail sector?

- Supplies of most goods and services are standard-rated (5%). Generally, prices are required to be displayed inclusive of VAT to ensure that consumers are not left to work out for themselves the final price they have to pay.
- Saudi Arabia and the UAE have zero-rated certain medicines and medical equipment, as in many other VAT jurisdictions.
- While the GCC treaty allows each state to zero-rate basic food items, they are standard-rated (5%) in both the UAE and Saudi Arabia. Other GCC states may choose to provide direct subsidies to citizens in lower socio-economic groups.
- Both the UAE and Saudi Arabia have announced plans for tourist refund schemes. GCC residents will not be eligible for VAT refunds.
- The GCC VAT rules require businesses to self-account for VAT when they provide goods or services for free. However, there are exceptions if no input VAT is claimed on the initial acquisition or if the total value of free goods or services falls below a minimum threshold. This is likely to impact promotional schemes such as loyalty and reward schemes.
- For sales to other GCC countries, retailers may be required to register and account for VAT in the other jurisdiction. For example, goods sold by a retailer in Saudi Arabia to a non-registered customer in Bahrain are zero-rated for Saudi VAT (since Bahrain has not implemented VAT). However, once Bahrain implements VAT and the electronic services system (ESS - a system designed to track the movement of goods within the GCC) is in place, the Saudi retailer must either charge Saudi VAT or register in Bahrain and account for Bahraini VAT if the Bahraini VAT registration threshold is exceeded. Exports from the GCC will be zero-rated, provided evidence of removal is obtained.

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- Special rules apply to the cross-border supplies of goods and services between businesses within the GCC. In essence, a reverse charge applies.
- VAT is generally accounted for at the earlier of the goods being supplied, the invoice date and the consideration being received. Since retailers tend to receive payment up-front, they will generally be in a cash-flow positive position.
- Retailers who provide finance or instalment plans should consider the impact of VAT on their cash-flow as they may need to account for VAT before they receive payment. Interest charged on financing arrangements will be an exempt supply, which will impact the recovery of VAT on costs incurred in the course of making those supplies.
- Retailers need to evaluate pricing strategies to take VAT into account. Retailers may choose to pass on the cost by increasing the price by the VAT amount, maintain their prices (effectively absorbing the VAT impact), or something in between. Any pricing decision will have to balance profit margins, sales volumes and market share.
- Saudi retailers may issue simplified tax invoices for supplies less than SR1,000 (US$265). In the UAE, the limit is AED10,000 (US$2,650). Other GCC countries are likely to set their own limits for simplified tax invoices.
- The VAT treatment of business promotions offered by retailers, distributor or manufacturer support schemes and vouchers and loyalty point redemptions are a complex VAT area and must be carefully considered.

What should retailers be doing now?

- Examine all supplies (goods and services) and assign the correct VAT treatment.
- Start the planning process early and look at marketing strategies to minimise any impact on profits, both during the lead-up to VAT implementation and after VAT is in place
- In the UAE and Saudi Arabia, purchases of high-value goods accelerated in the lead up to VAT implementation. Retailers in other GCC countries should consider stock levels in the months leading up to the implementation of VAT. A corresponding drop in sales of non-essential items following implementation is also likely.
- Consider the impact of VAT on pricing – should the cost of VAT be passed on to consumers?
- Review business promotions and agreements with customers and suppliers, particularly in relation to volume discounts, incentive payments, loyalty schemes and other adjustments.
- Examine any long-term contracts spanning the date of implementation and decide whether VAT can - or should - be charged to customers.

Important note

These briefs are based on a translation of the GCC VAT Treaty, UAE and Saudi Arabia's VAT legislation, the relevant regulations and general VAT principles and are provided for information purposes only.

Saudi Arabia and the UAE implemented VAT on 1 January 2018 and the other GCC countries continue – as of the date of release of this brief – to work towards implementation in 2019.

This brief is not a substitute for professional advice. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.