VAT brief | Automotive

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Saudi Arabia and the UAE implemented VAT on 1 January 2018. Bahrain has confirmed implementation on 1 January 2019, with the other GCC countries expected to follow over the next 12 months. Business leaders should now be more aware than ever that we have entered a new tax era. Key decision makers in the UAE, Saudi Arabia and Bahrain 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.
- 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.
- The mandatory registration threshold is the equivalent of US$100,000 - as set out in the GCC VAT treaty. The voluntary registration threshold is the equivalent of US$50,000.
- 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 does VAT affect the automotive sector?

- Most supplies made by auto dealers – such as the sale of cars, parts and repair services – are standard-rated.
- However, auto dealers also make other supplies. Certain financial services in relation to auto loans and credit are likely to be exempt from VAT.
- When providing finance, the appropriate VAT treatment will need to be considered:
    - Is there an operating or finance lease?
    - Is the dealer acting as an intermediary or directly providing financing?
- Auto dealers leasing cars generally need to account for VAT on the principal element of lease payments. However, they need to consider the impact of the imposition of VAT on customers and when to account for VAT, as specific time of supply rules apply.
- Supplies made under contracts that span the VAT implementation date (such as in lease-to-own or instalment payments) may be subject to special rules which determine when VAT is applied.
- Special rules may apply for second-hand cars, where VAT is only charged on the profit margin. The UAE, Saudi and Bahraini laws allow VAT to be applied only on the profit margin of eligible used goods. In Saudi Arabia and Bahrain, permission is required from the tax authority before this can be used.

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- The VAT treatment of demonstrator, employee and courtesy cars must be carefully considered as any element of private use will rule out the recovery of VAT incurred when bought.
- Dealers may sell more cars and parts in the run-up to the introduction of VAT, requiring them to increase stock levels in the months immediately beforehand.
- Cars sold prior to the introduction of VAT but delivered to customers after VAT may still attract VAT.

What should the automotive sector be doing now?

- Consider pricing and its impact on demand.
- Evaluate stock levels to deal with fluctuations before and after VAT implementation.
- Examine sales and accounting processes to ensure the correct VAT treatment is being - or will be - applied.
- Evaluate the impact of time of supply rules on deposits, warranties and service contracts.
- Review leasing contracts to confirm whether VAT can be charged following implementation - or whether transitional provisions apply.
- Examine any long-term contracts spanning the date of implementation and decide whether VAT can - or should - be charged to customers.