

An introduction to setting-up VAT in Saudi Arabia

The new Value Added Tax (VAT) to be introduced into the Kingdom of Saudi Arabia, and indeed all of the Gulf States, has been created in a very similar way to the European Union VAT structure, where each country is required to follow guidelines but each country is responsible for setting its own legislation around VAT.

What this means is that the Gulf Cooperating Council (GCC) countries are going to have very similar VAT structures and rules but each country may have some slightly different rules or rates, setting different items as being exempt from VAT, for example.

So, what does this mean for your ERP? What do you need to know and what can you do to get ready?

The following pages will explain what you need to know to get your solution ready. Of course, we hope you will take the easy and most cost-effective route and Contact Us to find out about our award-winning, fixed-price solution for fully automated VAT on Oracle ERP and Cloud.

Before we get into the details of VAT for Saudi Arabia, the new VAT system is being implemented as part of a GCC initiative but don't be confused to think this is a GCC VAT, it's not.

The first thing to understand is that there is not going to be one GCC regime. Instead each country will have their own regime.

This is important as when trading between GCC states takes place, the selling entity will not charge VAT and the buying entity will need to reverse charge the VAT. We will go into more detail on this later.

The second thing we need to know is that the GCC VAT treaty is just a set of guidelines. Whilst each GCC country has signed up to follow certain agreed requirements, it is still responsible for constructing its own legislation and as such can interpret the VAT treaty as it requires. This means we may have different tax logic for each country.

In reality, we expect that the laws will be very similar and the VAT rules almost identical. Lastly, the time frame set for the

VAT go live is 1st January 2018, for every country, but there is nothing to force each country to either go live on this date or for all countries to go live together. This should not cause any issues to your ERP system's tax automation.

What can we expect and how does this impact your Oracle or SAP implementation?



Taxable Person

A person or entity that conducts business for the purpose of generating income.



Place of Supply (POS)

Should by default follow the Ship-From location to the Ship-To location.



Free Zones

Beware! Current Free Zones may not be VAT-Free Zones.



Zero Percent Tax Rates

Don't make the mistake of assuming that if no tax is applicable then the tax is exempt!



Reverse Charge Mechanism

Commonly known as 'offset tax' and required when items have no tax on them but VAT is due.



Recovery

The ability for a company to get back the tax that is paid to a supplier.



Bad Debt (Treatment of VAT)

Any VAT recovered from a supplier who you have not paid within 6 months will need to be paid back!



Reporting

Your solution should be built around what you need to report such as UAE Emirates split and GCC reporting.



What to look out for!

Beware! VAT authorities are often different from other authorities such as Customs and Excise.



Taxable Person

What is a Taxable Person?

This, in effect, is an individual or entity that conducts business (an economic activity) for the purpose of generating income. However, for the purpose of setting up your ERP tax solution, a Taxable Person is most likely to be an entity because:-

In order to be liable for charging VAT, you need to generate approximately **USD \$100,000** which rules out many individuals.

To be a Taxable Person, you will need to be registered for VAT. So if buying from a non-taxable person then don't try and recover VAT from them as there won't be any!

We can assume, since you have a rather costly ERP system, that your company is registered for VAT. To make this simple, regardless of whether someone is a taxable person or not, when you are selling goods or services to them, you will apply tax in some form, which from early 2018, will be Value Added Tax (VAT).

When you make a purchase from a taxable person there will be VAT on the invoice. However, if you are buying from a non-registered for VAT company, then there will not be any tax on the invoice and the invoice should be treated as being out of scope for VAT.



Place of Supply (POS)

Where is the Place of Supply (POS)?

For an ERP system, or for tax automation, the Place of Supply (POS) by default should follow the 'Ship-From' location to the 'Ship-To' location. To understand what POS means, think of it like this, "**Do I need to charge Saudi Arabia VAT or not?**" If items are shipped from Saudi Arabia to Saudi Arabia then the place of supply is Saudi Arabia and the items will be taxable.

If, however, the goods were instead shipped to Qatar, then the place of supply is Qatar and the invoice would show 0% out of scope tax (of course, when Qatar receives the invoice, they will need to reverse charge the tax (more on this later). Now for goods, things get a little tricky. If your customer is in Qatar but instead of you shipping the goods to them, they come and pick it up from your location in Saudi Arabia. This would usually be indicated by a Freight Incoterm such as EXW (Ex-works). In this case, the 'Ship-To' is actually Saudi Arabia (your warehouse) and so the POS is Saudi Arabia and normal tax is applied! This can cause problems with your customer because they still need to bring this into Qatar where they will pay import tax again.

So, why is tax charged in this way? The reason is that your customer may pick it up and say they are taking it to Qatar but instead deliver it locally and have saved themselves the VAT. Our advice is that in most cases, if you trust the customer or they provide proof that the goods are going out of the country, then you can still charge the out of scope rate. With Oracle eBtax, we can actually use the Freight Incoterms to help automate the tax, including if the customer is a trusted customer or not.

But what about Services?

The first thing to consider is that in Oracle the 'Ship-To' field in Order Management and Accounts Receivable is not just there for the supply of goods. It can be used to indicate where the services took place. Services are harder to define but consider this example. If you conduct training in Saudi Arabia and your customer comes to Saudi Arabia to have the training, then the place of supply is Saudi Arabia and local VAT applies. If you do the same training but fly to the customer in Qatar then this is treated as export sales and out of scope of VAT.

There are other cases to consider however;



Land and Real Estate – POS is the location of the real estate property.



Passenger transportation – where transportation begins.



Transportation lease services – the location where transportation means were placed at customer disposal.



Restaurants and hotels – the location where the services are performed.



Telecommunications and electronically supplied services – the location where services are enjoyed. This also affects digital sales and the downloading of software, etc. Warning, you may need a customization to prove where the supply takes place!



Free Zones

What happens to existing Free Zones?

Some areas may be established as being VAT-free zones. Don't be confused with the current free zones that we see in some GCC countries because an existing Free Zone may not be a VAT-free zone, like those in the many areas of the middle east.

If you have an entity or warehouse in a VAT-free zone or one of your customers does, then you can flag your customer accordingly and when selling, your tax automation should zero-rate the VAT.



Zero Percent Rates

Zero Rated, Exempt or Out of Scope?

Don't make the mistake of assuming that if no tax is applicable then the tax is exempt. There are 3 types of zero-rated taxes; **Zero-Rated**, **Exempt** and **Out of Scope**. They impact how much tax you can recover, so they are particularly important in certain industries.

A simple way to look at this is that if all the items you sold were zero-rated (Medical Supplies) then you would still be able to recover

100% of the VAT on purchases. However, if all the items you sold were Exempt from VAT (Financial Services) then you would not be able to recover any of your VAT!

Exempted Supplies (Article 1(27) of the GCC VAT Agreement)

There will be guidelines on how to treat items that are exempt but each state is free to set their own rules around what is and what is not exempt from VAT. Examples of likely exempt items are;

- > Financial Services
- > Insurance
- > Charitable
- > Diplomatic
- > Military

Zero-Rated

The agreement across the GCC region is that the following must be treated as zero-rated supplies;

- > Medicine and medical equipment (under Article 31).
- > Goods and passenger transportation and other allied services (under Article 32).
- > Supply of gold, silver and platinum.
- > All sales that are considered as exports, i.e. the sales to a country other than Saudi Arabia.

Nevertheless, each state has the right to zero-rate other items as they see fit, rather than having to follow any guidelines. It is likely though that most GCC states will zero-rate items and these items will be very similar across all states.

- > Oil or oil derivatives
 - > Transportation
 - > VAT Group
 - > Land
 - > Multi VAT regimes
- (Article 4 of the GCC VAT Agreement)

Out of Scope of VAT

Certain supplies will be considered as being out of scope of VAT for Saudi Arabia. The most obvious ones are sales outside of the country or supplies made from a non-registered entity. But other examples for out of scope would be certain government activities or supplies made with no economic benefit. This includes providing goods or services to a different department in your own business.



Reverse Charging

Why do we need to reverse charge?

(Article 1(18) of the GCC VAT Agreement)

The reverse charge is a very common approach across all VAT or GST tax regimes worldwide and is also commonly known as self-assessed or offset tax. Reverse charging of VAT is required when you receive an item that has no tax on it but VAT is due. An example of this would be the receiving of services from Qatar. As the sale of service outside of Qatar is out of scope of VAT, then no tax is actually on the invoice. As it stands, it would make sense to buy the same service from overseas because it would not have any VAT on it and would appear cheaper, right? Well this is where the reverse charge comes in because any purchases that are made from overseas need to have the domestic tax rate applied and this means there is no financial advantage of buying a service from overseas compared to domestically.

The most common way of setting up the reverse charge mechanism is to use Offset Tax. This works by creating a tax with the type of 'Offset'. You can also set your reverse charge taxes up by using the 'Self Assessed' option as recommended in the Oracle documentation but there are two reasons why we at Innovate Tax do not use the self-assessed option other than for the US tax setups.

1. When tax is calculated, there is no tax line with self-assessed, so you need to click the tax details to check to see if there is any tax!
2. You need to have rules to drive self-assessed tax whereas offset taxes are directly linked to a VAT rate. Creating extra rules for self-assessed is a lot more extra work and does not work if the tax rate is changed manually!



Recovery

Recovering Tax – How and when?

You will have already read plenty of documentation that discusses how VAT works, in that at each stage of its journey, tax is charged to the customer and then the customer recovers the tax, if applicable.

The idea here is that 1) Tax is only ever really charged to the end user of the product and 2) the tax authorities get to collect tax on a regular basis receiving a regular cash flow. The ability for a company to get back the tax that they paid to a supplier is called Tax Recovery.

The Innovate Tax solution comes with two default tax recovery rates as standard, one for 100% and another for 0%. In reality, however, there can be multiple recovery rates depending on your business, your sales and the tax authority.

For most companies, the tax will be 100% recoverable but there will be items, such as business entertainment, that are likely to be 0% recoverable. Business entertainment is 0% recoverable for VAT because in the process of entertaining, you are 'enjoying' the service and qualify as an end user. That is why VAT is due but, you cannot recover any of it. An example of when the recovery rate maybe partially recoverable, could be linked to an employee phone bill. If an employee has a company mobile phone, then there is a high chance that the employee will use the phone for private calls during the weekend. The tax authorities may impose a partial recovery rate to only allow the VAT to be recovered for the portion used during office hours. So you may get a partial recovery for mobile phone usage of 78%, for example.

The rules for Saudi Arabia may differ from other GCC states, therefore be careful of the recovery rates used. The Innovate Tax Oracle tax solution will be able to fully automate the recovery rates using tax rules. In Oracle, the portion of the tax that is recoverable will go to a tax account whereas the portion that is not recoverable will go to the same account as used by the line expense the tax is related to.



Bad Debt

VAT Relief on Bad Debt

Luckily, this will not be a problem for you for at least 6 months after going live, should 6 months be the time allocated to bad debt on VAT. When you make a sale, you create an invoice and expect the customer to pay the invoice and of course VAT will be charged and

you will need to pay the tax authorities during the next quarter VAT return. But what happens if the customer does not pay? You will already have paid VAT to the tax authorities of Saudi Arabia, which, in the case of a large invoice could put a large dent, in your cash flow.

So, if there is an outstanding debt of 6 months or more, you are likely to be made to make a VAT adjustment and get that VAT back. Now, if the invoice is eventually paid, you need to pay the tax authorities, but if the debt is written off then you can write off the portion excluding VAT. The same goes for suppliers that you have not paid but instead of getting VAT back, you would need to pay the VAT back to the government for any VAT you have recovered but not paid. Innovate Tax have a solution that will automate this process for you.



Reporting

How do we report tax from our ERP?

Your standard, 'Out of the Box' generic Oracle tax report is the Financial Tax Register (FTR) and it is both basic and complex but it works – let me explain; The FTR is basically a dump of data and can produce over 200 columns of data in a report, most of which are of no use to you. The level of data it can bring back should meet all your basic needs. But be warned, if you don't want your users complaining, you will want to customize the report so that it only shows the data you need. Also, you will want to have the report open in Microsoft Excel, as the original version is a text file!

Do Innovate Tax use the FTR? Absolutely not! We do not see it being sufficient to meet your tax reporting requirements and we find it to not be very user friendly. As a consequence, we have created our own reporting suite that not only pulls the VAT data in the best possible way and presents it perfectly in Microsoft Excel, it also has error checking built in! Further to this, we have built it so that unlike the FTR, you can run the report based on the invoice tax date and not just the GL date. This means that you can recover more VAT sooner, as explained in further detail on our enhanced tax reporting product page.

What we found with Malaysia is that there was a requirement to be able to report the GST using special GST codes. We don't expect this to be the case for Saudi Arabia, but if there are any reports or extracts that are legally required, then these will be provided by Oracle. Malaysia also introduced a report called the GAF report that is ultimately a SAF-T (Standard Audit File – Tax) extract. They did not make it mandatory but, with the trend of the uptake of real time reporting by an increasing number of tax authorities, we expect that a SAF-T style report maybe created for Saudi Arabia. So, watch out for that. Due to the nature and volume of data that a SAF-T report extracts, you may want to look at the security of that data by reading our article on SAF-T – An invitation to insider Trading?.



What to look out for!

What should I be looking out for?

The Innovate Tax solution can be rolled out in minutes at a fixed price, so using us, you won't have any issues at all with your tax solution. However, there are a couple of areas that you will need to look out for, especially how goods are imported into the country,

because the VAT authorities are often different from Customs and Excise.

Customs and Excise

Something to consider, if goods are imported to Saudi Arabia but first come into the UAE, then the UAE may collect the VAT on behalf of Saudi Arabia. This is OK if the final destination is known. If it is not, however, it could become tricky to determine.

Digital sales

In the old days, something was made and sold and it was very easy to track the physical movement of the goods. Today, however, the majority of media is digital and no longer a physical item we can see but data that can be sold from anywhere to anywhere very quickly and very hard to track. Digital media can also come under different classifications because a DVD sold would be classified as a 'Good' but that same DVD downloaded could be classified as a 'Service'.

In the United States of America, goods are usually taxable but services are not. Hence, digital sales can mean a huge reduction in tax payable. What this means is that there are plenty of laws being introduced around the sale and purchase of digital media, so expect legislation for Saudi Arabia to be specific to this too. You will also need to consider how digital sales in Oracle can correctly identify the place of supply for the tax. A customer Bill-To address may not actually reflect where they are located and could be used to avoid VAT – which you will be liable for!

Timing

With our solution, we can get your test instances up and ready now to be able to test your system and be prepared for VAT. We will also ensure that all the correct rules and rates will be in place for going live. The point is that you should not be waiting until all the VAT legislation for Saudi Arabia has been announced before you start to get prepared. If you leave it too late, you may not be able to even find the resources to be able to do the work for you and end up with a poorly designed solution.

Custom Applications

Many of you will have built custom applications that are either part of your Oracle Suite or interact with it and will need to accommodate VAT. So, if you start testing now, then you can sanity-check your system to at least make sure VAT will work; you don't need to know the tax rates for Saudi Arabia to be able to do this.

The Future

We expect a fairly easy run for VAT for Saudi Arabia initially with generous VAT return reporting likely to be every quarter and only a standard tax rate of 5% with no reduced rates. Still, if we look at the trend globally, the rate at which tax returns have to be filed is increasing and we expect in the next 10 years, including for the GCC, that most tax returns will be automatically done as companies will be required to upload their tax data on a daily basis! So, reports like the SAF-T are likely to find their way into the GCC market too.

For the most cost-effective, best end-to-end and fastest to deploy Oman VAT solution contact us at Innovate Tax.

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