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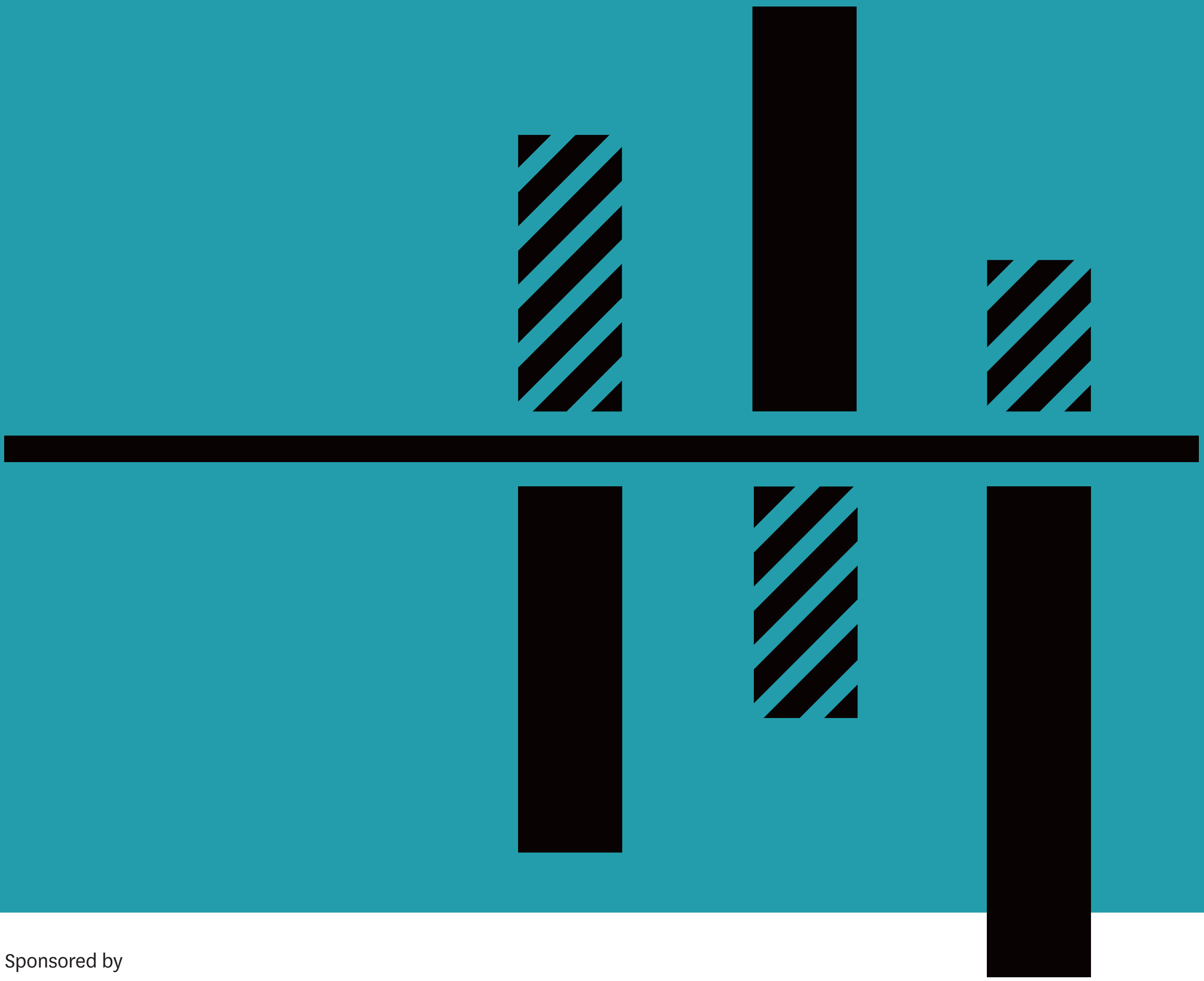
White Paper

VAT IN GCC: CLOUD ERP TO EASE COMPLIANCE FOR BUSINESS



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How to Get Started on VAT in the Gulf States

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ORACLE ECEMEA

It's official: 2018 will see the start of implementation of a value-added tax (VAT) across the Gulf states.

VATs have long been a standard source of revenue for other governments, including EU countries, Canada, Australia, and many others. But this is the first time that companies in the GCC will have to collect it.

VAT is collected at nearly every stage of the supply chain, from raw materials to the final product sold in stores. Ultimately, the consumer ends up paying for the tax—but businesses are still responsible for collecting the money on behalf of the government, and reporting on how much they collected, along with how much they were able to deduct based on their own costs. It's also important to make provisions and plan ahead going forward, and to bring a culture of change management to the organization.

This means that the vast majority of GCC companies will not only need to ensure they accurately determine and report on VAT requirements but, even more important, do it efficiently by automating this whole new process.

How can your company become compliant?

Fortunately, there are experts who have been dealing with VAT for decades in other countries. Here at Oracle, we have helped thousands of companies the world over comply with local VAT requirements. New approaches include connecting VAT cloud services to on-premises ERP (such as Oracle E-Business Suite) or simply taking the opportunity to fully modernize the enterprise by deploying ERP in the cloud.

In either case, there is a benefit to placing tax functionality in the cloud—namely, you always have access to the latest version of the software. Unlike on-premises systems, which require lengthy upgrades, cloud applications are updated by the vendor on a regular basis—so, if the amount of the VAT changes, or if another tax regulation is put in place, that functionality will be rolled out with the next release.

And with the cloud, either of these approaches can be completed in a much shorter time frame than an on-premises implementation. Cloud implementations typically take weeks rather than years.

This is good news, considering that the VAT deadline is only months away.

Established cloud providers like Oracle offer more languages, currencies, and country-specific rules than other, smaller finance cloud providers do. We also have an entire range of unique finance solutions covering the most basic to complex needs in the cloud—from stand-alone tax reporting applications to end-to-end finance processes, analysis, and reporting. This makes Oracle a logical choice for GCC companies, whose requirements are specific to their own region and unlikely to be met by other vendors.

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VAT Implementation: A Bold Move Toward Renewed Economic Growth

The six-member Gulf Cooperation Council (GCC) has finally joined the VAT bandwagon, and member states will start to introduce the tax in January 2018. The global oil price slump necessitated revenue diversification to avoid the risk of overdependence on hydrocarbons. According to EY, the proposed VAT rate of 5% is expected to contribute about 1.4% ($25 billion) to the GCC's annual GDP. FIGURE 1 A Unified Agreement for VAT, which lays down the guidelines for country-specific VAT legislation, was signed by each of the six governments.

Under the new tax regime, businesses would play a key role as intermediaries by collecting VAT from customers and remitting to respective governments. However, to be VAT-ready in time, organizations need to completely overhaul their taxation systems and related business processes. Considering the challenges businesses will face in their quest to become VAT-compliant, a massive wave of digital transformation is likely in the GCC. Key to this transformation would be process automation and ERP solutions that ease the VAT-associated burden on businesses. Cloud-based ERPs are expected to play an outsize role in this transformation, helping companies cope in a risk-free manner, especially under tight deadlines.

While Saudi Arabia, the UAE, and Qatar are set to roll out VAT in January 2018, the road to implementation will not be easy. Countries such as Malaysia and Egypt that have recently implemented a goods and sales tax (GST), similar to VAT, had tax infrastructure in place, and their preparation for VAT rollout involved upgrading their existing systems and aligning their business processes to changes in the tax structure rather than installing new systems. However, the GCC does not have such tax infrastructure in place. The region does have *zakat*[1] and some taxes for its non-GCC businesses, but these policies did not need elaborate tax infrastructure. Furthermore, in the case of Malaysia and Egypt, the implementation was done under a single tax jurisdiction, while for the GCC, six sets of legislation will come into play. To add to the complexity, GCC member states are implementing additional taxation policies along with VAT, such as the excise duty. In June 2017, Saudi Arabia started levying excise tax on certain products, and the UAE is set to introduce the same in the fourth quarter of 2017. Saudi Arabia has even announced a penalty of 10,000 Saudi Arabian riyals (SAR) for businesses failing to register with the government before the VAT law comes into force. GCC businesses, therefore, will have to prepare for the impact of dual or multiple taxation policies coming into effect almost concurrently, or face the financial implications of noncompliance.

A VAT RATE OF 5% WOULD CONTRIBUTE $25 BILLION TO THE GCC'S ANNUAL GDP

"Value-added tax planned for 2018 would not be raised above 5 per cent before 2020."
Mohammed Al Jadaan, Finance Minister, Saudi Arabia

"Value-added tax (VAT) will develop a wide financial change in Kuwait."
Anas Khaled Al Saleh, Finance Minister and Deputy Prime Minister, Kuwait

1 Zakat is a tax of 2.5% on the net income or net wealth of Saudi or GCC nationals engaged in business activities in Saudi Arabia, and is collected by the Department of Zakat and Income Tax (DZIT) within the Saudi Ministry of Finance.

FIGURE 1

KEY HIGHLIGHTS OF THE UNIFIED VAT LAW

VAT RATE	Standard VAT rate of 5% to be levied on the supply of goods and services
VAT CATEGORIES	• **Standard:** VAT to be levied at the standard rate of 5% on supplies such as vehicles, clothing, business consumables, etc. • **Zero-rated:*** Basic food commodities (approximately 90 items), pharmaceutical and medical supplies, oil and gas and their by-products, financial services, exports, etc. • **Exempt:** Essential food products, real estate, healthcare, education, local transportation, select government entities and charities
VAT REGISTRATION	• Mandatory registration for businesses with annual turnover exceeding $100,000 • Voluntary for businesses with annual turnover between $50,000 and $100,000
VAT FILING	• Businesses to file their VAT returns once every quarter • VAT will be levied on the net value received, i.e., after deducting discounts or rebates
VAT NONCOMPLIANCE PENALTIES	• 5% to 50% of tax liability or the amount overstated on failure to register, erroneous filing, overstatement of claims, or failure to pay on time • Imprisonment for repeat offense

*Zero-rated businesses cannot charge VAT but are entitled to receive a refund of VAT levied on their purchases.

FIGURE 2

CURRENT STATUS OF THE NEW VAT REGIME IN THE GCC

	STATUS OF COUNTRY-SPECIFIC LAW	NEXT STEPS	DATE OF ENACTMENT
SAUDI ARABIA	Draft law prepared; public feedback sought	Awaiting approval	January 1, 2018
THE UAE	Law approved by the Federal National Council (FNC)	Awaiting approval of the president, His Highness Sheikh Khalifa Bin Zayed Al Nahyan	January 1, 2018
QATAR	Draft law approved by the cabinet	Awaiting approval from the Shura Council and the emir	January 1, 2018
BAHRAIN	Draft law prepared	–	Mid-2018
OMAN	Draft law to be released soon	To be discussed with the State Council and Chamber of Commerce and Industry	To be announced
KUWAIT	Draft law in progress	–	To be announced

Country-specific VAT Laws Are Expected to Be Published Well Before January 2018

According to the VAT agreement, if two GCC countries go live with the VAT law by January 2018, the other four will be required to implement the same within the next 12 months. Since Saudi Arabia and the UAE are set to roll out VAT by January 2018, the rest are likely to follow suit by mid-2018. FIGURE 2

VAT Would Impact All Stakeholders in the Economy—Consumers, Government, and Businesses

Consumers in the GCC have thus far enjoyed subsidies and a largely tax-free status. Though the VAT is not expected to impact essentials, businesses could try to pass on the cost of VAT implementation to consumers. Also, in the case of imports, it is uncertain whether the governments would refund a variable or a standard VAT for imports from different countries. In case of the latter, businesses may pass on the excess VAT to consumers. Expats, who form a majority of the GCC's population, would also be affected. For tourists, individual member states can decide on the extent of VAT refunds and related administrative procedures. Thus, irrespective of whether a customer is a GCC national, an expat, or a tourist, VAT would lead to higher out-of-pocket expenses.

However, this requires a complete overhaul of the existing tax infrastructure. Establishing effective tax management processes and systems for both VAT collection and refunds, as well as hiring a skilled workforce, would be essential. Efficient processes and systems are also required for VAT assessment, audits, and refunds. moreover, tax authorities need to be prepared for uncertainties, failures, or breakdowns. For instance, the Malaysian government expected 40,000 businesses to register for GST, but 400,000 businesses ended up registering on the government website. Dispute settlement mechanisms, critical for handling ambiguous cases, would also be key to the implementation process. Having an impartial authority such as an

FIGURE 3

TRANSITION-RELATED CHALLENGES

PROCUREMENT	ACCOUNTING & IT SYSTEMS	SALES & PRICING	HUMAN RESOURCES
• Formulate new procurement strategies • Vendor management • Revisit contracts and arrangements	• Update financial and point of sale systems • VAT coding for payables and receivables • IT system changes • Electronic documentation/process automation	• Assess impact of VAT on demand/current contracts • Pricing strategy and terms of payment • Customer management	• Train existing staff • Hire IT and tax experts • Consider changes to the current organizational structure

ombudsman would help businesses voice their grievances and seek redressal. The UAE government has set up a three-tier appeal process in which the employees of the UAE Federal Tax Authority act as judicators.

"Our advice would be to **get ready soon**. Consider the overall impacts early. The absence of draft law is not an impediment to getting ready on many fronts, and **resources will be constrained** as we get closer to January 1." — Deloitte

Businesses will face the impact of VAT in two ways: by the additional investments needed for compliance, as well as the higher input cost of the new VAT, itself. FIGURE 3 However, they may refrain from passing on the entire input VAT to consumers owing to the fear of losing business. They may have to perform feasibility assessments to determine the extent of additional costs that can be passed on to customers. Companies with operations across the GCC also need to assess the impact of the various country-specific VAT rules, especially for exempt and zero-rated products, on their cash flows and profits. An indirect tax is being imposed in the GCC for the first time. Hence, the elements of tax have to be configured into the systems from scratch.

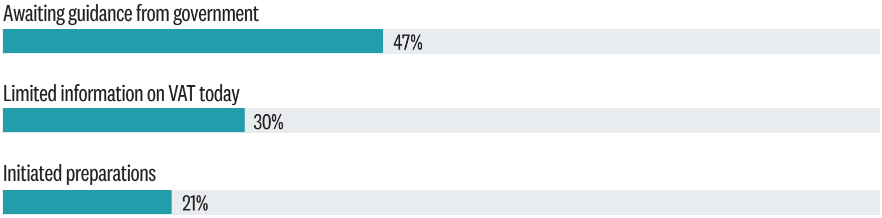
Only One-Fifth of Businesses in the GCC Have Initiated Preparations for VAT

A survey conducted by Oracle indicates that as of June 2017, only 21% of GCC businesses had started preparing for VAT, and more than three-quarters were still awaiting clarification from the government. FIGURE 4 With just a few months for VAT to go live, companies urgently need to change their business processes, upgrade or install new IT

FIGURE 4

ORACLE ANALYSIS

HOW PREPARED IS YOUR BUSINESS FOR THE VAT ON JANUARY 1, 2018?

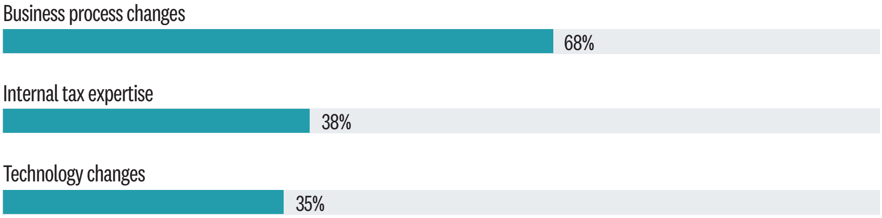


SOURCE: ORACLE SURVEY RESULTS, JUNE 2017

FIGURE 5

ORACLE ANALYSIS

WHAT IS THE BIGGEST OBSTACLE ON YOUR JOURNEY TO BECOME VAT-COMPLIANT?



SOURCE: ORACLE SURVEY RESULTS, JUNE 2017

systems, and scale up their workforce. Tax and IT consultants will also be needed to guide and prepare the organizations for the impending transition. Investments, therefore, need to be planned accordingly. Zero-rated companies, especially those with high CAPEX/OPEX, will have to assess the negative impact of VAT on their cash flows, factoring in the lead time required for VAT credits.

PROCESSES

Two-thirds of the survey respondents said that business process changes would be their biggest obstacle to achieving VAT compliance. FIGURE 5 As the VAT agreement comes into force, businesses will be required to maintain VAT payables and receivables separately, either electronically or in paper form, to assess net VAT payables and to justify their entitlements. Invoicing templates will also have to be changed to fit in relevant VAT fields. A majority of the GCC businesses still follow paper-based accounting systems, which can be cumbersome. In the ensuing chaos, adopting digital expense management systems will not only ensure a smooth transition but also eliminate the need to maintain onerous paper trails for each transaction.

SYSTEMS

Advanced IT systems will be key enablers of this business process transformation. An efficient ERP system would help organizations in mapping VAT transactions accurately, provide correct data for analytics, offer easy updates, and integrate into the system any changes to VAT policies in the future. For companies that already use some form of ERP solution, efforts will be directed more toward adaptation related to the proposed tax rate, billing and invoices, accounting, and reporting functionalities. For companies using two to three different ERP solutions (legacy systems) for various functions such as finance and CRM, more effort will be required for integrating data into one system or integrating VAT functionalities into each of the legacy systems.

TALENT

Hiring skilled resources would be another key step toward managing the transition to a new business process. According to an EY survey, only 13% of the companies consider education and training a focus area for ensuring VAT compliance. FIGURE 6 While training the current workforce for the required skills would be one part of the process, companies may also consider hiring IT professionals and tax or legal experts to manage the transition. FIGURE 7

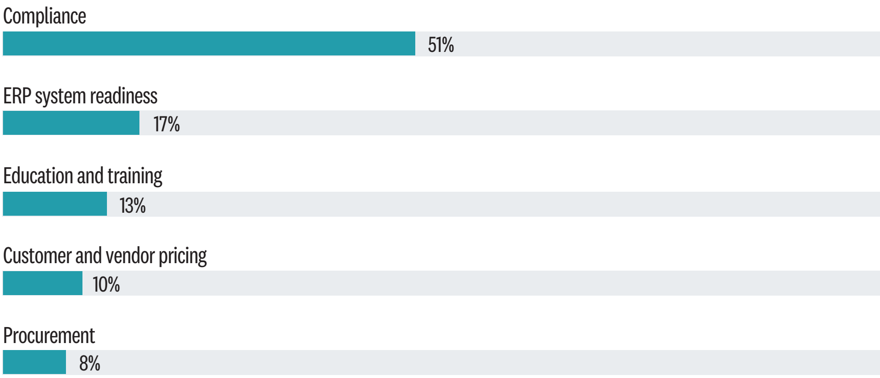
For change management, an organization would require a task force comprising a chief financial officer (CFO), a chief information officer (CIO), accountant(s), and legal and tax expert(s). It would be hugely beneficial to have a dedicated VAT director/manager or a VAT analyst for formulating strategies, managing risks, liaising with the regulatory authorities, etc. FIGURE 8

VAT Implementation Will Radically Transform IT Processes of GCC Businesses

VAT implementation will take the GCC one step ahead in terms of digital transformation, as businesses will be required to automate their processes to ensure that transactions are captured flawlessly and seamlessly in their systems. Of the surveyed businesses, nearly three-quarters consider the VAT project a part of their digital transformation. FIGURE 9

FIGURE 6

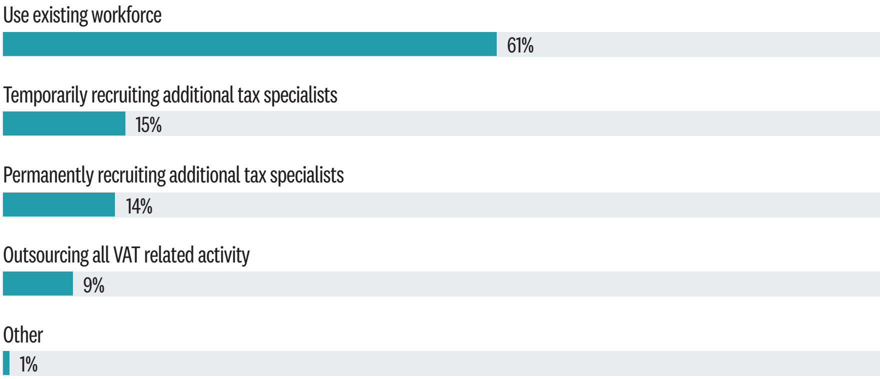
FOCUS AREAS FOR VAT PREPARATION



SOURCE: EY SURVEY RESULTS, FEBRUARY 2017

FIGURE 7

WORKFORCE STRUCTURE/REQUIREMENT FOR VAT IMPLEMENTATION IN THE UAE



SOURCE: HAYS REPORT ON VAT IN THE UAE, APRIL 2017

FIGURE 8

VAT COMPLIANCE STRUCTURE

LEVEL 1: STRATEGIC ROLE

CFO, CIO, VAT Director/Head of Tax

Set a strategic direction, provide support, and manage relationships with tax authorities

LEVEL 2: REPORTING ACTIVITIES

VAT Manager

Oversee operational activities, implement strategies, undertake training activities, and ensure VAT compliance

LEVEL 3: SUPPORTING FUNCTIONS

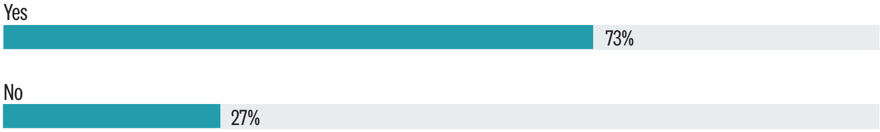
VAT Analysts/Accountants

Work closely with the finance team to ensure compliance and help formulate strategies

FIGURE 9

ORACLE ANALYSIS

IS VAT A KEY PART OF THE BIGGER DIGITAL TRANSFORMATION OF YOUR COMPANY?



SOURCE: ORACLE SURVEY RESULTS, JUNE 2017

A key question arises regarding the level of automation required. Businesses with simple IT infrastructures would need relatively less time and investment as compared with those that will have to incorporate automation from scratch or have complex IT landscapes. The most important decision is whether to use an on-premises or a cloud-based ERP system. On-premises software is installed on the company's servers. Cloud-based software is offered on the vendor's servers and accessed through a web browser.

Major factors to be considered while making a decision regarding the type of ERP to be deployed are:

- The capability of the existing systems
- The number of geographies that the firm operates in
- The number of daily transactions
- The budget allocated for the entire transition process

On-premise ERP systems require huge investments in terms of hardware, servers, and training needs. In addition, customization requirements and maintenance of hardware and servers incur significant costs. The need for constant upgrades creates a bottleneck for businesses, as the upgrades tend to wipe out previous customizations, and time and energy have to be diverted to get the system up and running again.

On the other hand, cloud-based finance and accounting systems make managing VAT extremely flexible and are known to reduce operational costs, as the cloud provider maintains the infrastructure and provides continuous updates, ensuring availability of the latest version of software without incurring additional costs. Moreover, cloud-based ERP systems can be accessed easily over the internet using smart devices. Cloud implementation requires less time compared with deploying on-premises ERP systems. Larger firms would have the financial resources required for an on-premises setup; however, smaller companies have to choose wisely, as having local IT infrastructure would prove to be costly and divert time and attention to noncore tasks, thereby affecting productivity. Of the total businesses surveyed, 66% said that they would transition their processes to the cloud if it helps optimize cost. FIGURE 10

Cloud ERPs take only weeks to deploy across an organization, and with just a few months for VAT implementation, cloud-based ERP is a desirable solution to VAT compliance. FIGURE 11

> "The system for VAT registration and payment is being developed to meet the very best global standards using leading-edge technology. **All services will be online and accessible 24/7**, responding to the requirements of business. This reflects the UAE's aim to be a leader in innovation and technology across all aspects."
> — The UAE Ministry of Finance

Conclusion

VAT is clearly the need of the hour for GCC governments. The tax is expected to augment government revenue and help diversify the economy from hydrocarbons. "VAT will bring many efficiencies and improvements in business transparency and record keeping and give the government greater data on the performance of the economy, so it may act as an improvement to the overall business environment," says a partner at Deloitte.

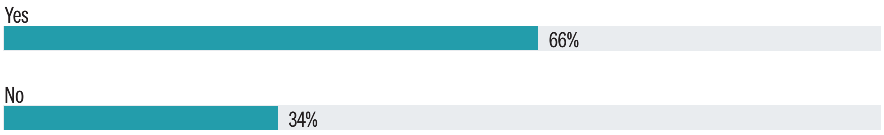
VAT implementation will serve as a catalyst for landmark change to IT processes of GCC businesses, as a majority of them would adopt ERP systems to ensure total compliance with the new taxation regime. Given the time constraints, gaps, and uncertainties surrounding country-specific VAT legislation, and concurrent implementation of multiple tax policies, adopting cloud-based ERP systems instead of on-premises systems could be a wise decision, as businesses would be released from the stress of updating systems in case the laws are amended or surprise provisions are introduced.

The road toward VAT implementation is clearly not free from hurdles. However, once the processes are in place, VAT rollout would greatly benefit the broader GCC economy.

FIGURE 10

ORACLE ANALYSIS

WOULD YOU CONSIDER TRANSITIONING YOUR BUSINESS PROCESSES TO THE CLOUD IF MAJOR COST SAVINGS FOR YOUR BUSINESS CAN BE DETERMINED?



SOURCE: ORACLE SURVEY RESULTS, JUNE 2017

FIGURE 11

CLOUD-BASED ERP SOLUTIONS: A FASTER APPROACH TO VAT COMPLIANCE

VAT IMPLEMENTATION CHALLENGES	ON-PREMISES ERP SYSTEMS	CLOUD-BASED ERP SYSTEMS
Time to achieve VAT compliance	Longer	Shorter
Cost of implementation/compliance	Higher	Lower
Flexibility of integration with supply chain stakeholders	Lower	Higher
Need for dedicated skilled resources/training	Higher	Lower
Ease of accommodating future policy amendments/revisions	Lower	Higher
Ease of integrating multiple tax policies	Moderate/Lower	Higher
Knowledge and expertise	Managed in-house	Provided by vendor

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CONTINUED FROM INSIDE FRONT COVER

Knowing Where to Start

So, where do you start to determine which approach is best for you? Deploy a new ERP in the cloud? Keep your core ERP and connect cloud VAT services? Or move some of your finance functions to the cloud?

There are a number of factors to consider:

- What is the age of your existing ERP system? Are you running the latest version of the software, or are you on an old edition?
- In how many countries do you do business? The more geographies, currencies, and languages you operate in, the more rules, regulations, and compliance issues you will need to consider. It might be worth a full-scale migration to cloud in order to keep on top of all the permutations.
- How many transactions does your ERP process in a day? The higher the transaction volume, the more important it is that your core system be scalable enough to meet demand.
- Are you looking at a full ERP replacement in the near future? If so, it might make sense to take a phased, "outside-in" approach—starting with tax applications in the cloud to meet the immediate VAT deadline, and then moving core ERP to the cloud at a later date.

No matter which approach you decide on, VAT is coming. Every GCC business will need to comply. I recommend that you form a project team as soon as possible to understand how VAT will impact your business and operating model.

Assess the capability of your existing systems to comply with the new regulations. And then, choose an implementation partner and a software vendor with the real experience and capabilities to meet your needs.

— ARUN KHEHAR, SENIOR VICE PRESIDENT APPLICATIONS, ORACLE ECEMEA

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