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ASSESSING GCC VAT IMPLEMENTATION THROUGH SINGAPORE CASE STUDY

GCC VAT FORUM

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“Singapore’s VAT modifications demonstrate how the basic structure of the VAT can be successfully adapted to fit the particular circumstances of a country, provided it is done with care to practical issues of compliance and administrative feasibility. The case of the implementation of the Goods and Services Tax (GST) in Singapore comes close to being a “best practices” framework to guide other governments toward a successful introduction of this important system of taxation.”

The member states of the GCC have been debating the idea of implementing a Value Added Tax (VAT) for well over a decade without ever feeling the need to fully commit to such a course of action. This stance changed in late 2015 when the Council decided that the current tumbling of oil prices now necessitates a diversifying of the states’ revenue streams and in order to shift their reliance away from hydrocarbons.

Therefore, in 2018, a VAT of between 3-5% will be imposed across the GCC countries – details dependant on the unification of the tax policies of individual states as well as decisions on exemptions for specific sectors.[1] This will be a huge change for the region, given its historical lack of indirect taxation and as such it will mean a significant period of adjustment for business enterprises operating within the GCC.

In order to be as adequately prepared as possible for the introduction of the new tax, companies of every size, in every non-exempt sector, must understand exactly how it will affect their ongoing operations and what adjustments will need to be made. In order to highlight some of the key considerations regarding VAT implementation, it can be beneficial to examine a past example of a similar tax under similar circumstances.

Process of VAT Implementation: A Study of Singapore

“Singapore’s VAT modifications demonstrate how the basic structure of the VAT can be successfully adapted to fit the particular circumstances of a country, provided it is done with care to practical issues of compliance and administrative feasibility. The case of the implementation of the Goods and Services Tax (GST) in Singapore comes close to being a “best practices” framework to guide other governments toward a successful introduction of this important system of taxation.” – Glenn Jenkins and Rup Khadka, “Value Added Tax Policy and Implementation in Singapore”

“A fairer tax – A brighter future.” – GST advertising campaign slogan

Background: Singapore’s path to VAT implementation shares a number of common features with the GCC, albeit with markedly different timeframes. As early as 1966, a blanket VAT implementation was suggested but, like the Gulf States, the Singaporean Government decided that imposing consumption-based tax would be unfeasible due

[1] *Emirates 24/7, VAT to be introduced in UAE in 2018 @ 3-5%: Official, 14/01/2016*

to potential economic disruption and public disapproval of indirect taxation. The proposal was promptly shelved for the next two decades with only brief and periodic revivals of interest.[2]

However, by 1986, Singapore's corporate income tax rate and top marginal personal income tax rate both stood at 40% and such high rates were considered uncompetitive. Singapore had a heavy dependence on such taxes for its national revenues and wished to diversify, much in the same way that the GCC is currently aiming to reduce its dependence on oil to sustain the member states' economies.

In 1994, Singapore introduced the Goods and Services Tax (GST), a broad-based VAT at a rate of 3% levied on most goods and services with some exemptions made to reflect special areas of the country's economy. The implementation was considered to have been carried out in a smooth, fair and consistent manner thanks in large part to the foresight of the ministerial planning teams and the continual cooperation between the government and private sector.

Specific GST Implementation considerations that are Relevant to the GCC VAT

Instant implementation: to avoid confusion and uncertainty, plans to phase in the GST over 5 years were scrapped in favour of broad-based implementation all at once. The GCC has similar plans to enact instant implementation of VAT across all six member states, principally to avoid encouraging the smuggling of untaxed goods across borders, which would cost governments millions in lost revenues.[3] This will mean that VAT-eligible businesses need to be prepared for the set 2018 deadline or suffer the consequences of non-compliance.

Small businesses: A threshold of SGD $1 million annual turnover was set for GST applicability, in order to avoid putting undue compliance costs on small vendors who would be less likely to keep accurate sales records.[4] Similarly, smaller GCC-based businesses will need to be aware of the impending VAT's threshold in order to determine whether they are required to pay it.

Transitional measures: Usually, when countries adopt VAT, some interim provisions and exemptions need to be made in order to avoid double taxation under the likes of general sales taxes. Since Singapore had no general sales tax, very few provisions needed to be made except in areas such as long-term supply contracts.[5] The case will be similar in the GCC due to its current lack of consumption-based taxes, though enterprises will need to research any transitional measures implemented by their government to see if any apply to them.

Training and Technological measures: Implementing the GST required multi-agency participation, the creation of a GST governmental division, the training of 200 officials

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[2] *VAT Monitor, Value Added Tax Policy and Implementation in Singapore, 03-04/1998*
[3] *The National, GCC pushes on towards introduction of regional VAT, 11/05/2015*
[4] *Singapore Ministry of Trade and Industry/Ministry of Finance, The Goods and Services Tax, 1993*
[5] *VAT Monitor, Value Added Tax Policy and Implementation in Singapore, 03-04/19986*

and the design and development of an interdepartmental computer system. However, this was in the mid 1990s, and the GCC's challenge will be much more pronounced due to the vastly more advanced and complicated technological and entrepreneurial environment that we now live in.

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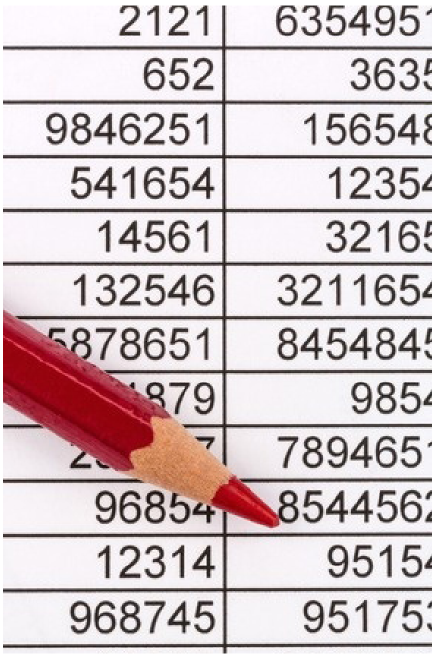

Not only will the respective governments of the GCC need to prepare for auditing and collecting VAT, business enterprises will have to develop the appropriate processes and technological systems for recording and paying VAT-eligible transactions.

Going Live: When implementing any sales-based tax, the actual day of implementation usually represents the greatest area of difficulty. The Inland Revenue Authority of Singapore (IRAS) took a number of measures to avoid problems on the day the GST went live such as suggesting retailers develop two tags: one pre-GST and one for post-GST. This clearly showed consumers the total price of their purchase, eliminating confusion.

GCC enterprises will need to consider the potentially thorny issue of how to cross over the VAT implementation dateline, once it has been determined.

Top 5 Points for the GCC to consider before 2018 VAT Implementation

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Although Singapore's VAT implementation was conducted without having to tackle the specific challenges of a massively integrated and digitised global economy, there are a number of key challenges and solutions that are entirely relevant to the GCC's situation. Each of the following considerations were carefully analysed by Singapore's government and private sector participants in order to prepare both sides for a smooth transition.

The Cost of Compliance

"Although the principles of VAT are broadly the same everywhere, the compliance burden on businesses varies considerably. Streamlining the compliance burden and reducing the time needed by businesses is important for the efficient working of VAT systems." – PricewaterhouseCoopers LLP, "The impact of VAT compliance on business"

Since GCC-based enterprises have not needed to operate around a sales-tax system before, the adjustment of their accounting and record keeping processes will be significant. Therefore it is essential that businesses effectively analyse their current operational setup to accurately determine the initial and ongoing costs of complying with the impending VAT rate. These costs may include:

Systems development: ICT systems alterations, including change of invoicing processes and tech upgrades.

Staff training: Educating key staff members in VAT principles and their impact in an operational context.

Ongoing costs: Continual record keeping, auditing fees and VAT payment processes.

The Cost of Non-Compliance

"Unfortunately, the nature of VAT is that whilst tax liabilities are "self-assessed" and paid over by businesses, errors are typically subject to heavy penalties. Any type of tax fraud is usually subject to heavy civil and/or criminal penalties and we would expect that the same approach be taken in the GCC." – Deloitte, "VAT in the GCC: Old news or new chapter?"

VAT compliance comes with attached costs, but so does non-compliance. Any business enterprise that meets the annual turnover threshold for VAT eligibility and fails to accurately record and pay the required tax, runs the risk of having the discrepancy discovered and reported via government audit. Either through negligence, ignorance or fraud, non-compliance may carry penalties of severe fines, restriction of business operations and other sanctions to be decided by the GCC governments leading up to 2018.

For example, current penalties for non-compliance with VAT in certain EU states include fines of twice the amount of VAT unpaid without any upper capping limit (Denmark and Belgium), whereas other states impose upper limit direct monetary fines of up to €125,000 (Slovenia).[6]

Implementation of New Technologies and Processes

The imposition of a brand new tax requires the development of new business processes in order to carry out the recording and payment of VAT-eligible transactions. For Singaporean businesses, this meant altering their existing ICT system or in many cases developing a new one just for this purpose.

The technological state of computing in 1994 was significantly less advanced than it is today, which makes the GCC's situation either more or less challenging by comparison, depending on the circumstances of individual companies. Some major international enterprises may find this a more significant obstacle, due to the heightened complexities of incorporating major new processes into an existing ICT legacy system. However, other companies may have a less difficult scenario if their ICT operational setup is flexible enough, due to the possibilities offered by advanced and innovative technologies such as cloud computing and Application Programming Interfaces (APIs).

Either way, it will be essential for companies to determine the most accurate and cost-efficient way to incorporate VAT into their operations.

Coordination between GCC Governments and the Private Sector

"The business community was not hostile to GST. The openness and willingness of the government agencies to listen to the business community won their confidence and the community became part of the GST preparation and implementation process." – Value Added Tax Policy and Implementation in Singapore

The respective GCC governments and private sectors represent the two sides of the implementation equation and have to work together in order to ensure its success. A key facet of this cooperation will be in the delivery of a taxpayers' education programme. In order to get the private sector ready for the change, governments will need to work with leading business enterprises to develop the right campaign (utilising modern media and ICT technologies) to educate everyone

[6] *Taxomeno, EU VAT Non-compliance: severe penalties await, 24/06/2014*

"Unfortunately, the nature of VAT is that whilst tax liabilities are "self-assessed" and paid over by businesses, errors are typically subject to heavy penalties. Any type of tax fraud is usually subject to heavy civil and/or criminal penalties and we would expect that the same approach be taken in the GCC."

about how VAT will work: its purpose, sector-specific rates, exemptions, compliance, predicted impact, all relevant information will need to be delivered in a manner that is clear, unambiguous and easily understood.

Both the government and private sectors of GCC member states also have a vested interest in educating the public about VAT. Doing so will eliminate public confusion and therefore prevent consumer confidence being undermined – a scenario that could lead to reduced sales or lower customer satisfaction.

As well as a well-coordinated education programme, individual enterprises should consider informing their key clients and suppliers about their intended approach to implementing VAT, for the same purpose of reassurance and eliminating confusion.

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Evaluation of Cost Burden: Company, Supplier or Consumer

"Consumers may ultimately see their cost of living rise within the sultanate, particularly if businesses choose to increase their prices to maintain their profit margins." – Oxford Business Group, "New taxation schemes in Oman would affect businesses and consumers"

Traditionally, the majority of the burden of VAT falls on the consumer as businesses adjust their prices accordingly. However, this should not be an automatic response for GCC enterprises, as even a small price increase could ultimately precipitate a marked slowdown in sales. This is particularly true of consumer goods or services that are already viewed as being "luxury" or overly expensive.

Therefore, GCC enterprises will have to carefully analyse who should absorb the cost of VAT and in what proportion. Innovative pricing points, sales models and marketing strategies can help lessen the burden and ensure that the change doesn't bring a ruinously negative impact on sales.

2018: VAT's GCC Debut: Are you Prepared?

"The design of VAT puts businesses in charge of charging and collecting VAT, then remitting it to government at agreed times. For businesses unfamiliar with VAT, implementation can require a significant change to business operations." – Deloitte, "VAT in the GCC: Old news or new chapter?"

The introduction of an entirely new indirect tax will have a marked effect on the respective economies of the GCC, as each enterprise decides how best to prepare for its arrival. Determining how to effectively absorb the initial and ongoing costs of VAT, in a way that ensures accuracy, compliance and consumer satisfaction will place any given enterprise in a position of peak preparedness.

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GCC VAT FORUM

With VAT regulations expected to be implemented by 2018, each and every company in the GCC needs to ensure they are VAT-ready. Therefore, we're bringing together experts from **KPMG, Deloitte, Ernst & Young and Emirates NBD, alongside other CFOs and Senior Finance Managers, at the GCC VAT Forum,** taking place from **30-31 August 2016 in Dubai, UAE** to help you identify and overcome challenges brought on by the introduction of VAT.

Visit **www.gccvatforum.com** for more information.

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