THOMSON REUTERS PROJECTS:

Implications of VAT Implementation on the GCC Construction Industry

Executive Summary

In the first week of October 2017, Thomson Reuters Projects hosted a roundtable in Dubai to discuss the recently announced Gulf Cooperation Council (GCC) Unified VAT Agreement and its effect on the construction industry. The roundtable brought together both local and regional industry players, providing a platform for them to voice any concerns and gain further clarity from value-added tax (VAT) experts from Deloitte Middle East and Thomson Reuters.

Guest speakers Nurena Tarafder, Senior Manager of the VAT Team at Deloitte Middle East, and Pierre Arman, Marketing Development Lead – Tax & Accounting and Global Trade Management at Thomson Reuters, were chosen for their in-depth knowledge and experience of working with government agencies and authorities on GCC VAT.

Topics covered included the impact of VAT on the construction industry's complex supply chains and on roll-over contracts, competitiveness of local firms, how to raise VAT invoices without impacting cash-flows, timelines for claiming back VAT and preferred IT software for VAT filings.

Following the two-hour roundtable, participants said they had gained a better understanding of the GCC Unified VAT Agreement and its application in different member states, particularly Saudi Arabia and the United Arab Emirates, who are expected to 'go live' with VAT on January 1, 2018.

Participants concurred that governmental bodies should provide more clarity on the technicalities of VAT filing procedures, VAT import/export implications, VAT reporting for joint ventures and potential penalties.

The roundtable gave participants a unique opportunity to receive bespoke advice on the topic and influence future legislation: the issues raised in the session will be shared with government agencies and authorities responsible for refining VAT laws.

The details of what was discussed during the roundtable are covered in this white paper.

Introduction

Last year all six member states of the GCC (Saudi Arabia, United Arab Emirates, Kuwait, Bahrain, Oman and Qatar) agreed to implement a unified tax system similar to the VAT system in the European Union. GCC member states signed the common GCC Unified VAT Agreement detailing the main principles of how the VAT system will operate across the bloc. Although each member must abide by the treaty's rules, there is some flexibility and certain aspects of the VAT system can be fine-tuned according to local needs. Examples of this are the frequency of filing VAT returns, timelines for when payments must be made and which sectors are granted VAT relief.

Key features of the GCC Unified VAT Agreement, outlined by Deloitte:

- The standard VAT rate will be 5 percent applying to most goods and services unless a zero-rate or exertion applies.
- Supplies of goods and services from a VAT-registered person in one member state to a VAT-registered person in another member state is subject to reverse charge mechanism.
- VAT grouping permitted between two or more legal persons resident in the same member state (UAE and Saudi Arabia will allow this, if there are a number of entities within a corporate group that are connected then they may be able to form a VAT group and apply for a single VAT registration and submit a single VAT return which would make things administratively simpler for the business).
- The treatment of GCC free zones is not addressed and is left to each member state to determine its own VAT treatment for free zones.
- Businesses with an annual revenue exceeding $100,000 will be required to register for VAT.

After signing the treaty, member states are expected to issue their domestic VAT legislation that will set out detailed rules on how VAT will operate domestically. To date, Saudi Arabia has published its own VAT law (or primary legislation) and is implementing its final regulations (secondary legislation containing more detailed rules).

The UAE recently published its VAT law and its executive regulations are slated for release in October 2017. Both Saudi Arabia and the UAE have said January 1, 2018 is their 'go live' date for launching VAT and this is unlikely to change. Furthermore, certain sectors such as healthcare, financial services and transport will be granted preferential treatment.

Oman, Bahrain and Qatar are expected to 'go live' in the second half of 2018 and Kuwait on January 1, 2019.

UAE federal tax authority

In 2017, the UAE issued the Federal Tax Procedures Law which stipulates the rules around administering taxes. These include when the Federal Tax Authority (FTA) has the right to inspect a business, how much notice it must give and other aspects that concern the relationship between the tax-payer and tax authority. The UAE has launched an FTA website and its registration portal is now open for VAT registration.

Furthermore, the UAE Ministry of Finance has organised various sessions country-wide to discuss VAT and how the system will operate. More recently, the ministry has held industry-specific sessions.

VAT in the UAE (Announcements to date)

- The Federal Tax Procedures Law was released in the UAE and will govern the general rules and procedures relating to VAT and other taxes.
- The UAE published its VAT law in **August 2017**.
- The UAE's Federal Tax Authority (FTA) website went live in **August 2017**.
- UAE-based businesses should be able to register online for VAT from **October 2017**.
- The Ministry of Finance is organising events tailored to different audiences and industry sectors to discuss the VAT legislation.
- Businesses now have access to the law, so can better understand the potential impacts VAT will have on their business processes and reporting obligations.
- All these updates indicate the UAE is committed to the VAT 'go live' date of **January 1, 2018**.

VAT relief and exemptions

The GCC Unified VAT Agreement gives member states flexibility in certain areas, plus "reliefs" that can be applied to certain goods, services and sectors. Within real estate and construction, member states can choose to exempt, zero-rate or standard rate building materials supplies.

In Saudi Arabia, residential lettings are exempt of VAT but all other supplies of real estate are subject to the standard-rate VAT.

In the UAE, residential property lettings are exempt, as is the sale and leasing of undeveloped land. UAE citizens constructing their own homes will be able to obtain a refund on VAT incurred.

New residential housing in the UAE will be zero-rated. Developers which have built residential property and sold it within three years can also apply for zero-rate on VAT. This allows the developer to recover the VAT on the construction costs unless it is already exempt from VAT.

Commercial property sales and leasing will be standard-rated. Construction is not mentioned as receiving specific tax relief. By default, the construction sector will have to apply the standard rate of VAT.

The GCC Unified VAT Agreement (VAT liability under the GCC VAT Treaty)

Must zero-rate

- Medicine and medical equipment
- Cross-border goods and passenger transportation services
- Goods exported outside GCC territory
- Certain cross-border supplies for non GCC recipients
- Certain transactions in gold, silver and platinum

May zero-rate

- Certain food items
- Supply of means of transportation for commercial purposes
- Oil, oil derivatives and gas sector

May either exempt or zero-rate

- Education sector
- Healthcare sector
- Real estate sector
- Local transport sector

Must exempt

- Financial services (with some flexibility to tax)
- Importation, if the goods are
  - Exempted or zero-rated in the country of importation
  - Exempted from customs

It is important to note that there is no specific relief for the construction sector in Saudi Arabia and UAE. It is possible, however, for other GCC countries to offer tax relief for this sector.

Cross-border transactions

Specific "place of supply" rules will determine where a transaction is taxed and this is particularly important for cross-border transactions where the customer and supplier are based in different jurisdictions. The supply of real estate services will take place at the property location and the construction services VAT will be accounted wherever construction services are performed (or where the property is located).

Executive regulations have not yet been published in the UAE, but real estate services in the UK and EU are covered by tax authority guidance and experts expect similar rules will be applied in the UAE.

VAT Liability in Saudi Arabia and UAE

- Both Saudi Arabia and UAE have zero-rated the international transport of passengers and goods, and related goods, including intra-GCC transport.
- Local transport is standard-rated for Saudi Arabia and exempt for the UAE.
- All food items are standard rated in both Saudi Arabia and the UAE.
- In Saudi Arabia, residential real estate rental is exempt, all other real estate is standard rated. In the UAE, residential rental and undeveloped land is exempt. New housing is zero-rated but all other real estate is standard rated.
- Education is standard-rated in Saudi Arabia, although public education is not expected to be subjected to VAT. In the UAE, education services will be zero-rated.
- Healthcare – in Saudi Arabia, qualifying medicines and medical goods will be zero-rated and public health is unlikely to be subject to VAT. In the UAE, specified services will be zero-rated.
- Oil and gas industry will be standard rate in Saudi Arabia and the UAE.
- Means of transport (e.g. airplanes for passengers) will be zero-rated in Saudi Arabia and the UAE.
- Export of goods and services will be zero-rated in Saudi Arabia and the UAE.

VAT Liability (Construction sector specific rules)

- As a starting point, all domestic supplies of goods and services are subject to the standard VAT rate of 5 percent unless specifically zero-rated or exempted.
- There is no specific relief for the construction sector in either the UAE or Saudi Arabia VAT laws.
- Real estate-related services will be taxed where the real estate property is located; real estate services shall mean those services are closely linked to real estate, including services relating to construction work.
- Each member state may exclude the following categories from paying tax: citizens of member states when constructing their homes for private use (UAE has allowed a refund).

VAT accounting

There is some confusion within the construction industry about when VAT should be accounted for, given the number of documents and certifications issued by construction companies. Ms Tarafder clarified VAT for contracts containing milestones or staged payments will need to be accounted for as soon as payments are received.

When to account for output VAT on supplies (Key concepts detailing when and how much VAT is due)

- **Time of supply:** This is the time at which the supply is 'recognised' for VAT purposes and the liability arises to account for output VAT.

  It is used to ensure VAT is declared in the correct tax period.

- **Output VAT:** The amount calculated and charged on a taxable person's sale of goods and services.

  - Time of payment
  - Date of Invoice
  - Receipt of goods/ services

Pro-forma invoices, applications and certifications are not covered by the VAT law. Construction firms, in possession of certification from customers, are advised to issue VAT invoices as the time at which the VAT invoice is issued will determine when VAT is accounted (not when the certification is received).

If a company issues a VAT invoice before it receives payment from the customer, VAT will need to be accounted for in the VAT return that covers the time at which the invoice was issued.

In the United Kingdom, it is common for construction companies to issue a demand for payment after receiving the certification from the customer, in order to avoid triggering a VAT liability before receiving cash from their customers. The demand for payment is not a VAT invoice and has no VAT consequence, but allows the customer to see the VAT amount due. The customer then pays the amount demanded, triggering the VAT obligation - at that point, the construction firm has received payment without causing a cash-flow issue.

Milestone payments

If a company has a service contract with milestone or staged payments, VAT is triggered after each payment is made or each VAT invoice is issued. If a contract is a single payment contract, then VAT will be triggered when either the final invoice is issued or the services are completed - whichever event is earlier.

Delegates asked whether a company could adopt a VAT invoice process until December 31, 2017, and then adopt a different process thereafter, because up until this date all work-in-progress is not VAT liable. Ms Tarafder advised companies to certify up until December 31, 2018, because there will be transitional provisions that will take invoices and payments made after January 1, 2018 but which relate to works carried out in 2017 outside the scope of VAT.

The same can be done with uncertified clients, if companies raise invoices and receive payments after 1 January 2018 for work conducted in 2017, the transitional rules will take those payments outside the scope of VAT. However, companies will need evidence to show the work was conducted before 2018 - getting work certified up to December 31, 2018 will facilitate this.

If milestone payments are made before and after January 1, 2018, executive regulations will allow contractors to apportion that invoice.

Net billing

Delegates were informed that VAT should be accounted for on the net billing of a contract. Moreover, advance payments received in 2017 will be subject to VAT if relating to work after January 1, 2018, and companies should account for the net of their invoices in 2018.

UAE law states that contract which are silent on VAT and which straddle January 1, 2018, will be treated as inclusive of VAT and VAT will not be added onto the contractual price. However, if the customer can recover VAT, then the contract should be treated as exclusive of VAT. If the contract is silent on VAT and the customer can fully recover the VAT charged, then the construction firm can treat the contract as exclusive of VAT and add VAT on top of price.

Legal guidance

Delegates were told to seek legal advice when reviewing whether their contracts are considered silent, because most contracts include a clause acknowledging changes to country tax laws. While most businesses will be able to recover VAT, it is important for companies – especially those working for a commercial developer also able to recover VAT – to have a pragmatic conversation with their clients if a contract is unclear on VAT.

In these cases, the customer is advised on the matter and has the option to accept or reject the company adding VAT and amending the contract in line with the new laws.

VAT will be charged on arbitration awards where necessary. If there is a dispute and a construction firm is paid an amount, VAT will be charged. Receiving the award would trigger the tax point.

Advance payments

There was confusion amongst participants on the advance payment rules. Participants were advised to wait for the publication of the executive regulations, which will cover payments received prior to January 1, 2018, and will relate to services formed or goods delivered after January 1, 2018. It was reiterated that VAT must be accounted on advance payment and companies may have to go back and ask their customers via a VAT invoice to pay for the VAT element.

It is still uncertain when companies will need to account for VAT on spread-out advance payments, but any advances after 2018 will be subject to VAT.

In Saudi Arabia, there is more guidance on advance payments and invoices issued before the implementation date.

If a project is completed after January 1, 2018, but partly executed earlier, retention payment will generally be subject to VAT unless the project was completed or handed over before January 1, 2018. If the project is partially completed before and partially completed after, that outstanding part would be subject to VAT.

When companies invoice the net amount they should only invoice for services that have been certified without advance payment or retention. The VAT is deducted from the gross value of the services and if the project is ongoing, retention rates after 2018 will be subject to VAT.

Silent contracts

The transitional rules in Saudi Arabia are different to those in the UAE. Contracts dated before May 30, 2017 that are silent on VAT and for which the customer can recover VAT can be zero-rated for VAT. The customer must certify they can to recover VAT in full and therefore payments received from customers after January 1, 2018 can be zero-rated and construction firms do not have to charge VAT.

Companies must apply default rules for contracts executed after May 30, 2017. If a contract is silent on VAT it is considered inclusive of VAT, and construction firms must account for VAT once payment has been received (unless the company is able to renegotiate contract terms).

Contracts entered into before May 30, 2017 which are within the transitional provisions and for which payments will be received after January 1, 2018 can be zero-rated.

If a contract explicitly states it is inclusive of taxes, a company will not be able to rely on transitional provisions which are only for contracts silent on VAT. Contractors will be at risk because they are legally unable to charge VAT on top of the contract price. Unless the customer accepts a change in contract, companies will have to pay the VAT from their own profit margins or, if possible, pass on the costs to their contractors.

VAT invoices

VAT invoices must be issued by law and the customer must have a VAT invoice to recover VAT. There may be commercial disputes if there is no penalty for companies that do not file VAT invoices.

Time of supply – UAE Transitional provisions (Article 80 in UAE VAT Law)

- Where company B is registered for VAT and is entitled to recover VAT on their costs incurred, Company A can treat the contract as if the price stated was exclusive of VAT.
- Company A can therefore charge VAT to Company B in addition to the price stated.

Time of supply – Saudi Arabia Transitional provisions (Article 83 in Saudi Arabia implementing regulations)

- In Saudi Arabia, the general rule is that all supplies of goods and services made in Saudi Arabia and imports into Saudi Arabia on, or after January 1, 2018 will be subject to VAT.
- VAT is only due on the portion of the supply that took place after January 1, 2018.
- Advance payments/ invoices are considered to have been made or issued on the actual supply date for the purposes of determining the date those goods or services were supplied.
- In certain cases, if a contract entered into before May 30, 2017 does not anticipate the application of VAT to the supply, the supply may be treated as zero-rated by the supplier until the contract either expires or is renewed, or until December 31, 2018

Any GCC country that has not introduced VAT on 1st January 2018 will be considered a country outside the council territory. A taxable person who receives goods from these countries will be deemed to have imported those goods into Saudi Arabia for VAT purposes.

IT systems

Delegates were urged to start looking at their company's IT capabilities on key issues such as how to issue VAT compliant invoices, how to account for VAT on transactions and how their VAT return process will work. Most delegates said they have already done so and some had already instructed their group companies to register online on 15 September in the UAE.

Pierre Arman, Marketing Development Lead – Tax & Accounting and Global Trade Management at Thomson Reuters, warned delegates that some legacy and in-house built systems may have very limited VAT capabilities and put them at risk of being non-compliant. He told them they need to assess their systems capabilities and look at their technology options in case VAT logic cannot be supported in their current systems.

Delegates asked which systems would be best for this and were told most recent ERP systems have some VAT capabilities but it is always based on hard coded logic, meaning any change in the legislation will need to be manually updated by the delegates' IT team in each impacted internal system. Delegates were also told that indirect tax specific platforms exist today which can automate both the indirect tax determination process within one's source systems (tax engine concept) and the associated VAT reporting process (rather than typically using Excel if VAT compliance is done in-house).

Delegates voiced concerns about a lack of clarification on the reporting requirements and its impact on master data. They said it may be time consuming to get data from suppliers such as VAT numbers so as to populate their software and at the moment they are still not clear on the implementation regulations.

Mr Arman reiterated the most advanced systems should have some VAT capabilities but companies need to be mindful about using multiple systems. Indeed, multiple systems would complicate matters when VAT regulations are amended down the line as companies would need to make changes to all the systems multiple times every time and would therefore see a sharp increase in maintenance costs on these systems.

Mr Arman recapped companies may eventually have to upload a file manually into the FTA website in the beginning to auto-populate certain fields of the online VAT return on the FTA website. Although this is not currently available on government websites it may be before the January 1, 2018.

E-filing process

Mr Arman told delegates the general consensus at the moment is the UAE VAT form will be a web form on the FTA website which will be pre-populated via an upload file by companies, although certain fields might still require a manual input. The VAT return is then reviewed and filed online and provide companies the ability to pay as well, directly in the FTA website.

It is expected the FTA will eventually move towards a total e-filing process, in a similar fashion to what exists today in Europe for instance, and will allow companies to send their VAT return in a specific digital format directly into the FTA website, without any manual intervention required.

Companies are also expected to report their VAT output via an emirate breakdown in the UAE, though rules on this have yet to come out in the executive implementation regulations.

Guidance on freezones

There is currently no detailed guidance on free zones, but the executive regulations will contain rules on VAT. The UAE VAT law states there will be designated zones treated outside the UAE – the identity of these zones will be included in executive regulations. Fenced free zones such as Jebel Ali Free Zone may be considered a designated zone outside the UAE.

Joint ventures

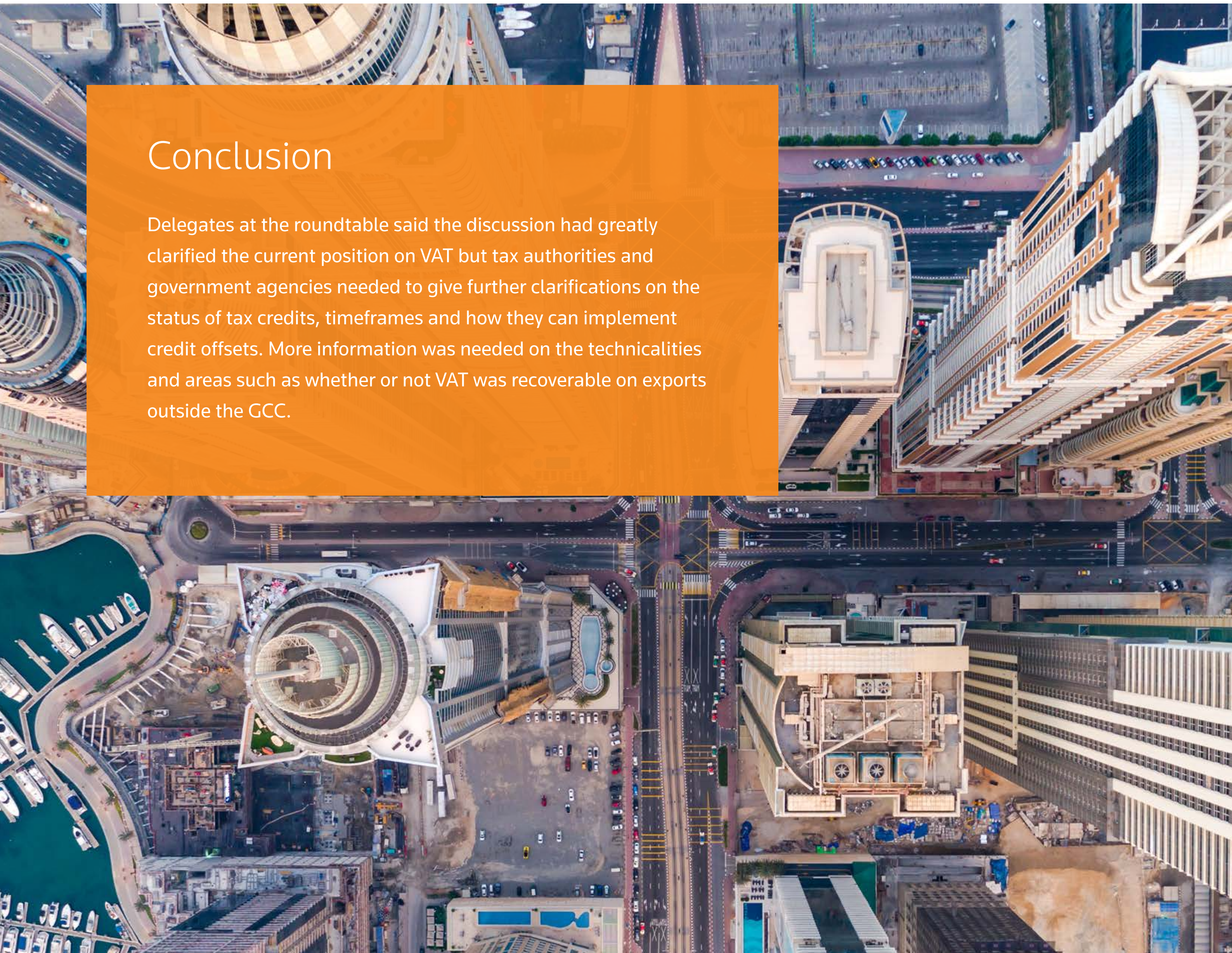
In the UK, unincorporated joint ventures can register and file VAT invoices as a partnership and can account for VAT on transactions jointly. The UAE is also expected to follow the UK in this and allow joint ventures to register for VAT.

Bad debt provisions

If a company receives a late payment which was invoiced before 2018 and paid after the 'go live' date, the company will not be liable for VAT.

If a company raises a VAT invoice before it receives payment from the customer and that invoice is outstanding for six months or more and certain other conditions have been filled (such as amount has been written off from the books of company) then the company will be able to reverse the VAT it has accounted for at the time it raised the VAT invoice.

Delegates voiced concerns about 5 percent VAT negatively impacting their single digit profit margins and were advised to prioritise negotiations with customers so that they accept new payment arrangement to help manage the company's cash-flow.



Conclusion

Delegates at the roundtable said the discussion had greatly clarified the current position on VAT but tax authorities and government agencies needed to give further clarifications on the status of tax credits, timeframes and how they can implement credit offsets. More information was needed on the technicalities and areas such as whether or not VAT was recoverable on exports outside the GCC.

List of participants:

Name	Title	Company
Moderators		
Nurena Tarafder	Senior Manager	Deloitte
Pierre Arman	Market Development Lead Tax & Accounting and Global Trade Management	Thomson Reuters
Attendees		
Agnes Koltay	Managing Director	Koltay Façade
Mark Paver	Chief Financial Officer	Brand Energy & Infrastructure Services SGB
Shakti Arora	Chief Procurement Officer (CPO)	RAK Ceramics
Ali Tabbal	Chief Financial Officer	Omniyat Properties
Jimmy Tracey	Chief Financial Officer	Gulf General Services
Sathya Srinivasan	Head of Strategic Consulting & Research	Cavendish Maxwell
Yvonne Cross	Counsel - Infrastructure & Construction	Ashurst
Andrew Hatherly	Chief Financial Officer	JLL
Colin McDaid	Finance & Admin Director	Turner International Construction
Nick Guest	Chief Financial Officer	Arabian Construction Company (ACC)
Prabakar Raut	Group Chief Financial Officer	ASGC
Suleyman Turkel	Accounting Manager	TAV Construction
Jay McKinnon	Managing Partner	Re-Think VAT Advisory Firm
Nathan Banks	Chief Financial Officer	Banks Legal
Rajesh Ammanathil	Chief Financial Officer	RMJM
Sandra Kowalewska	Finance Manager	RMJM
Jean Moussa	Chief Financial Officer	CCC
Gary Lowndes	Senior Group Financial Controller	Drake & Scull
P. Jayaprakash	Head of Finance & Accounts	Larsen & Tubro Construction ME
Lakshmi Narasimhan B	Deputy General Manager - Corporate Audit Services	Larsen & Tubro Limited
Ravi Kumar	Deputy General Manager	Shapoorji Pallonji
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