

# How VAT impacts you

## Education sector



### **VAT in the GCC**

The 'Gulf Cooperation Council' (GCC) states are gearing toward the introduction of a 'Value Added Tax' (VAT) in the region commencing on 1 January 2018. The proposed VAT will tax most goods and services with a limited number of specifically exempt or zero rated supplies.

VAT registered businesses that supply goods and services subject to VAT at standard rate or zero-rate are usually entitled to claim a 'credit' for VAT paid on their business expenses (input VAT). However, in case of supply of exempt goods and services, no input tax credit will be available. Therefore the VAT cost will be borne by these businesses.

### **VAT impact on educational institutions**

Prescribed education supplies are traditionally exempt from VAT and this may be the case in the GCC although some countries could be contemplating the application of a zero-rate. Exemption means that no VAT will be charged on the provision of such supplies and VAT incurred in relation to making these supplies can not be reclaimed. Prescribed education supplies may include course fees (including any administrative fees which directly relate to the course), course materials, field trips and excursions as well as food and accommodation to students.

Educational institutions have evolved to provide more than just education to their students; they are now often involved in business activities such as the sale of goods from campus shops, restaurants, vending machines, admission to plays, concerts, dances and museums etc. They may also provide short term courses to non-students/the general public, all of which are likely to be subject to VAT.

The likelihood in the GCC context is that educational institutions will make supplies which would be considered as exempt as well as supplies that are subject to VAT. This will mean that VAT incurred on inputs which are directly attributable to the exempt educational

supplies will not be claimable. To further complicate matters, VAT incurred on common overheads (such as marketing and promotional costs, utilities, purchases of office furniture and goods) will not be fully claimable and must be apportioned, meaning that only a portion of VAT incurred on such expenses is claimable in proportion to the amount of taxable supplies made over total supplies.

Historically, experience in other VAT jurisdictions shows that educational institutions tend to recover only 5-10% of all VAT incurred based on a standard method of apportionment (i.e. turnover basis). Thus costs are expected to significantly increase for educational institutions as a result of VAT. These costs will be further compounded by the higher compliance costs faced by educational institutions to ensure correct tracking and attribution of all their inputs and VAT claims.

The additional irrecoverable VAT costs will impact pricing policy. An early assessment of the VAT bottom-line cost is required in order to rebalance prices in time for 1 January 2018 in order to maintain current levels of profitability.

Educational institutions may wish to consider developing a special method of apportionment based on a 'fair and reasonable' apportionment method which can lead to higher recovery rates and reduce VAT costs (compared to the standard method of apportionment).

### **Capex projects**

VAT will impact the cost and budgeting of capital expenditure projects (such as construction of a new school or faculty building or procurement of IT or laboratory equipment). Adverse effects on cash flow must be considered in advance – especially when the VAT may become an irrecoverable cost. It is therefore imperative that careful planning of upcoming capex projects is performed to minimize the VAT impact.

## Situations where determining the VAT treatment can be a challenge

The following are some of the most common situations where determining the correct VAT treatment can be a challenge:

**Catering** – Food and drink supplied by canteen operators (third party or in house) to students may be exempt from VAT. Supplies of food and drink to non-students (e.g. staff) may be standard rated.

**Accommodation** – It is common for educational institutions to also provide accommodation to students, teachers and faculty. The accommodation may be let out (e.g. during non-term time) to visitors such as visiting academics staying overnight for a course.

These types of supplies could follow the general VAT treatment of supplies of residential accommodation which are traditionally exempt from VAT or may be considered as related to the provision of exempt education supplies and treated as exempt. Accordingly input tax incurred on maintenance costs and upkeep of the building is irrecoverable. This may be absorbed into the price charged to the students or borne by the educational institute.

However where the accommodation is let out on short term basis as holiday lets or overnight stays to the general public, these types of supplies could be considered as standard-rated for VAT purposes.

**Conferences** – The VAT treatment generally depends on whether the primary purpose of the event is educational in nature. If the conference is for educational purposes and delegates are charged a fee for entry this may be exempt from VAT as a supply of education. Where a conference is not educational in nature, then it will be subject to VAT.

**Research grants** – Grant income for research and the VAT liability of research undertaken by an educational institution is complicated and may or may not attract VAT. Whether the institution is treated as providing a service to the donor is the trigger for any VAT liability on the institution. It will be important to examine any contracts to identify the correct VAT treatment.

## Accurate VAT classification of all business transactions

Main services provided by educational entities, for example the provision of accredited courses, are traditionally treated as exempt. However non-accredited courses, such as short term courses provided

to non-students, are often considered taxable. Stand-alone administration fees (which are not directly related to any course) charged to students are sometimes treated as taxable. However, where the administration fees charges are incidental to the supply of an exempt education service, then these too will be treated as exempt for VAT purposes.

Therefore appropriate VAT controls and processes will need to be established to ensure the correct VAT treatment applies on a transaction-by-transaction basis for all business supplies.

The correct VAT classification of education services will be crucial as it will dictate:

- Where VAT has to be charged; and
- The base for claiming input VAT credits on expenses.

## Systems, Procedures and People

An assessment of the capabilities of existing IT systems and re-configurations necessary in order to generate VAT compliant outputs is crucial. In many cases, significant changes will be required to IT platforms and present workflows and processes.

### In summary

The above is just a sample of the many issues that will impact education institutions under the VAT. Addressing your stakeholders' concerns in advance of the VAT will be critical.

It is essential that your staff are fully cognizant of VAT. It will be difficult to 'systemize' the VAT rules for all supplies made by you: nuances in the VAT law or slight changes in fact scenarios can lead to varying VAT outcomes, as described above.

'Will the cost of education and tuition fees rise?' There is often a misconception that when you are exempt from VAT, VAT will have no effect on your business (and prices). In fact it is the opposite and exempt businesses are the ones most affected. Early preparation is crucial and many of these issues may be resolved and the impact mitigated.

At PwC, we have a strong indirect tax department with many years of experience in VAT matters impacting educational institutions, both in the Middle East and abroad, and we are in an excellent position to help you during this transitional period.

## How we can help – VAT implementation

1	Conduct VAT awareness briefings	2	Assist with classification of your business transactions
3	Review your long term contracts and propose VAT specific changes	4	Undertake a VAT cost financial analysis
5	Provide a VAT implementation plan	6	Advise and support on systems, compliance and training

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