



How VAT impacts you

Oil and Gas 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 incurred on their business expenses (input VAT). However, in the case of supplies 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 Oil and Gas companies

In most VAT jurisdictions, supplies of oil and gas, including oil and gas exploration projects are treated as taxable supplies for fiscal reasons. Ordinarily, VAT registered companies are allowed to recover the VAT incurred on their purchases by offsetting this against the VAT charged on their sales.

It is expected in the GCC region that supplies of oil and gas may be taxable at zero-rate for VAT purposes. Zero-rate means that VAT will be charged at zero per cent on the provision of such supplies and VAT incurred in relation to making these supplies can be reclaimed in full.

Some of the taxable supplies in this sector are drilling services, seismic surveying, pipeline operations, leasing of ships, storing and handling of installations, Farm-out/Farm-in of goods, refinery and warehousing services and sale of hydrocarbons, amongst others.

Irrecoverable VAT

The initial stages of exploration may last anywhere up to eight years and are characterised by large amounts of capital investment/expenditure. Usually, VAT systems allow for voluntary VAT registration of businesses *intending to make taxable supplies*, despite the businesses not making any actual taxable supplies.

However during this exploration period, the tax authorities may disallow Oil and Gas (O&G) companies to voluntarily register for VAT if the businesses do not intend to make any taxable supplies within a 12 or 24 month period (as was the case recently in Malaysia).

In such a scenario, any VAT incurred on purchases is not recoverable until the business is registered (which may be several years later).

A time limit of six years is usually applied in most VAT jurisdictions in back claiming such expenses and claims are usually limited to input tax incurred on capital goods only held on hand at the time of VAT registration.

This additional VAT for the O&G sector may impact the cost of the project. Early assessment and management of the cost, and cash flow impact is essential to ensure the viability of the project.

Under some potential VAT models specific supplies may be exempt from VAT. These may include the importation and local supply of capital goods specifically used in the O&G sector.

For the suppliers of these supplies, no VAT will be charged on the provision of such exempt supplies and VAT incurred in relation to making these supplies will not be claimable.

O&G players might wish to analyse the impact of VAT on their business model and make an early assessment of the VAT bottom-line cost in order to manage profitability in time for 1 January 2018.

Refunds vs cashflow

As exports of products are likely to be zero rated, some O&G companies may likely be in a continuous net refund position of VAT input tax credits with the tax authorities. These companies will need to be cognizant that within the first 12 months after the introduction of VAT, the tax authorities may delay in paying refunds of VAT. Such delays will put added pressure on O&G companies cash flow.

Thus it is imperative to account for this and any upcoming significant capital expenditure to plan and manage the business' cash flow by minimising 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:

VAT status of sub-contracting arrangements – Upstream sub-contractors can account for anywhere between 75%-90% of all supplies made to O&G companies during the exploration and production phase. Most of these sub-contractors only provide these services exclusively to O&G companies. Whether or not zero rating or exemption of VAT of the O&G companies is also extended to include O&G subcontractors under the Product Sharing Contract(s) may have a significant impact on the industry.

Transferring goods temporarily for processing – It is common practice for O&G companies to enter into agreements with third parties to have their goods 'transferred' to be processed and/or treated by the third party and then returned. Determining whether the Farm-out and Farm-in arrangement relates to transfer of goods or merely the provision of services has always been a contentious issue for the O&G sector under VAT.

Suspension/Temporary Importation (TI) – In many instances, O&G companies may import significant capital equipment temporarily for it to then be re-exported to the country of origin.

For example, it is common practice for O&G companies to rent/lease oil rigs from non-resident suppliers into GCC waters. Whether the tax authorities disregard the VAT on the periodic lease payments and treat this as an importation of goods with the VAT applicable only once, at the time of importation. How VAT is treated upon importation of the equipment may significantly impact the cash flow of the company.

Royalty payments and production sharing/cost recovery arrangements – Under the PSC arrangement how costs are recovered, royalties paid and profits divided is stipulated within. Ensuring the correct VAT treatment is applied is crucial in order to avoid disputes with your counterparties and the tax authorities.

VAT treatment of repairs and maintenance – Complexities around determining the correct VAT classification on repair and maintenance services on ‘floating production and storage offloading facilities’ (FPSOF) where these facilities are located in national, GCC waters or international waters.

VAT treatment of deposit on returnable gas containers – It is common practice for the downstream O&G players to sell Liquefied Petroleum Gas (LPG) in returnable containers. First time buyers pay a security deposit in the event that the container is returned. The VAT treatment of the security deposit has been a contentious issue.

Borrow and return or swapping of crude oil arrangements – O&G companies often enter into ‘borrow and return’ or ‘swapping of crude oil’ arrangements based on demand and location of their corresponding customers. For VAT purposes these are treated as separate and distinct transactions, requiring the issuance of valid tax invoices documenting a valuation for each of the discrete transactions.

Swapping of assets – It is common practice for O&G companies to swap assets with third parties especially where both of them are short of cash. Determining the taxable value for these arrangements might be a key consideration.

Farm-out and Farm-in transactions – Most of the O&G companies enter into transactions with third parties to diversify risks associated with exploration and also to raise funds for exploration activities. Determining whether Farm-out and Farm-in transactions relate to transfer of goods or services has been one of the contentious issues in the O&G sector.

Tax point and valuation of work obligation – Farm-out and Farm-in transactions involve one party assigning interest to another party (third party) for a consideration mainly in the form of upfront cash and future work obligation i.e. drilling well or incurring specified development and operating costs. Complexities around determining the valuation and tax point for the work obligations need to be considered.

Compliance requirements under Joint Operating Agreements (JOA) – Determining the VAT liability and compliance requirements for the operator and consortium members under JOA.

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 O&G players under VAT. Addressing your concerns in advance of the VAT go-live date will be critical.

It is essential that your staff are fully cognizant of VAT. It will be difficult to ‘systemise’ 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. The oil and gas industry is currently undergoing an extremely difficult period and companies operating in this sector often face significant tax liabilities given the size of their operations.

At PwC, we have a strong indirect tax team with many years of experience in VAT matters impacting O&G players, 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

Talk to us

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