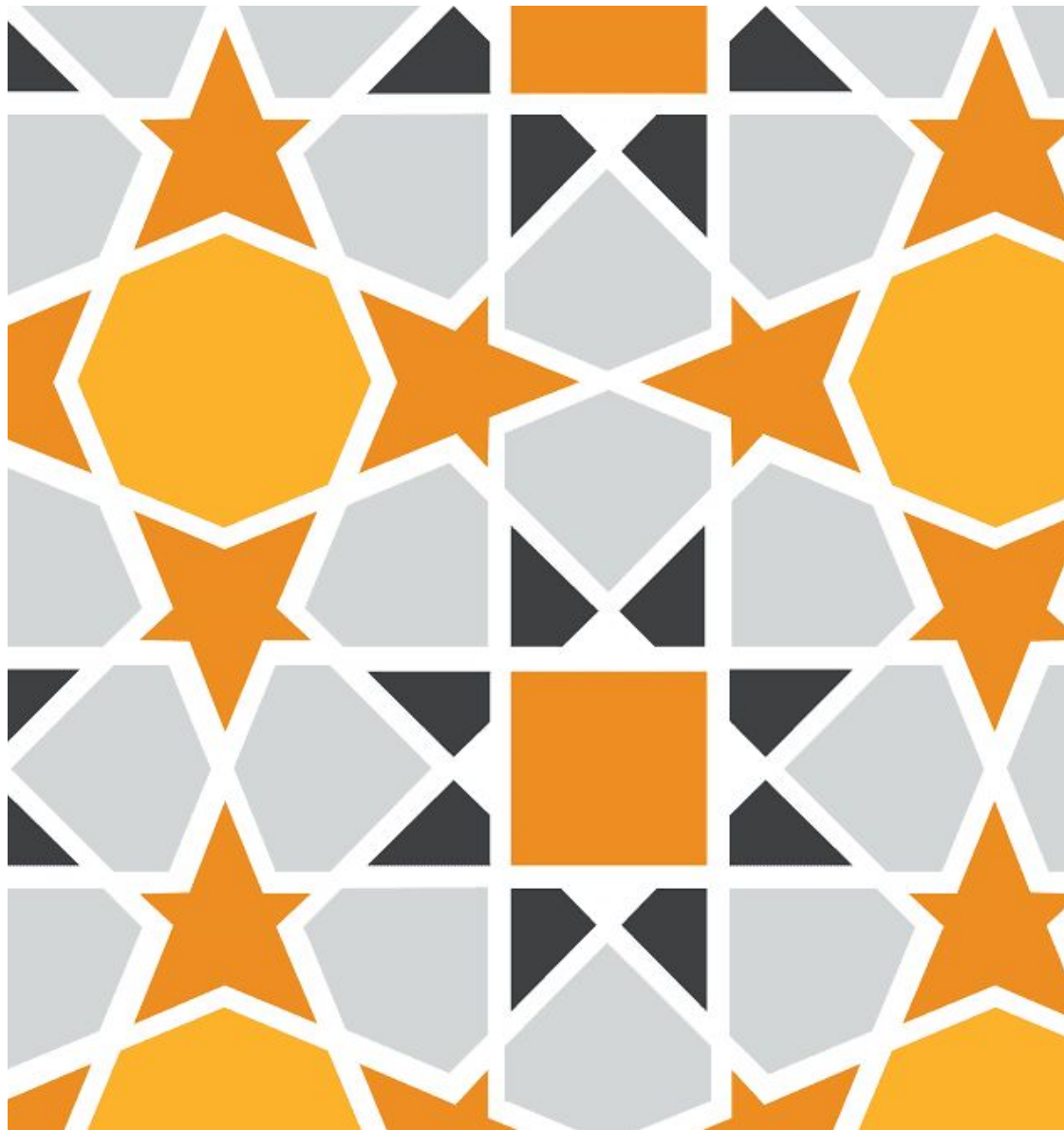


Saudi Arabia: Circular on the VAT treatment of certain supplies in the Financial Services Industry

January 2023





In brief

The Zakat, Tax and Customs Authority ('ZATCA') published a Circular on its official website to provide guidance on the application of VAT law and its Implementing Regulations on the following transactions:

- Supply of services by KSA based financial institutions to customers located outside KSA
- Incentives provided by international credit card issuers and payment network operators to KSA based financial institutions
- Interchange services and associated fees

The Circular also includes some important definitions such as interchange fee, issuer bank, acquirer bank etc in the context of interchange services which are not available in the VAT law and its Implementing Regulations.

The Circular, issued in [Arabic](#) as well as [English](#) languages, also includes illustrative examples and guidance material to facilitate the taxpayers in assessing and applying the correct VAT treatment on the aforementioned transactions.

In detail

Supplies of services by KSA based financial institutions to customers located outside KSA

The Circular highlights that financial institutions should consider the following factors while determining VAT treatment for a service:

- Place of supply of services
- Nature of services
- Location of customer

Services provided by the financial institutions usually fall under 'general place' of supply concept as prescribed in the GCC VAT Framework Agreement which means the place of supply will be where the financial institution is located.

The next step would be to assess the nature of services and depending on the circumstances, consideration of services may either be treated as:

- Explicit fee or commission etc - Subject to 15% VAT
- Implicit margin or spread - Exempt from VAT
- Services provided to a non-resident customer - Subject to 0% VAT (Article 33 exceptions assessment will be required)

In case of application of 0% VAT under Article 33 of the Implementing Regulations, the Circular includes examples and clarifications for each of the exceptions mentioned therein the



For interchange services, the location of PNO should be disregarded and due consideration should be given to the location of Acquirer Bank and Merchant to apply the correct VAT rate.





aforementioned Article which taxpayers may use as a guidance in order to apply correct VAT rate.

This Circular also reiterates that unless all GCC states have not introduced VAT and Electronic Services System is not implemented, the GCC member states will be considered as another country for the purposes of applying relevant provisions of the VAT Implementing Regulations.

Incentives provided by international credit card issuers and payment network operators to KSA based financial institutions

In the context of incentives or rebates provided by international credit card issuers and payment network operators, ZATCA clarified the VAT implications that financial institutions should consider (depending on the contractual and commercial arrangements between the parties) while entering into such arrangement, which typically are classified into two broad categories:

Contractual arrangement	VAT implications
Supply of service by the bank to the credit card company	Where the bank agrees to perform certain activities for the benefit of the credit card company in return for the payment, this will be considered as a supply of service by the bank to the credit card company and the bank should issue a tax invoice (after applying correct VAT treatment) in relation to such service.
Reduction of the consideration for earlier supplies made by the credit card company	Where no services shall be seen to be provided by the bank, ZATCA is of the view that the credit card company is merely granting a commercial discount on the earlier supplies made with respect to meeting predetermined volume targets. In this case, the credit card company should issue a credit note to reflect the adjustment to the consideration of the original supplies.

Interchange Services

ZATCA in the Circular explained the mechanics of ‘interchange services’ by way of highlighting parties involved, how interchange fee arises, and how it should be treated from a KSA VAT perspective if the parties involved are KSA VAT registered or located outside KSA.



What is an Interchange fee?

Interchange fee represents amounts paid by Retailer's bank (Acquirer Bank) to a card holder's bank (Issuing bank). Typically the following parties are usually involved where a customer uses his credit card to make a purchase:

- Cardholder
- Retailer/ Merchant
- Issuing Bank (who issues the credit card)
- Acquirer Bank or POS Bank (Merchant or retailer's bank)
- Payment Network Operator (referred to as 'PNO')

Critical VAT considerations related to interchange fee

In the event where the PNO is located outside KSA however the Acquirer Bank and Merchant are located in KSA, ZATCA considers this to be a domestic supply of service and hence the standard rate of VAT will be applicable.

ZATCA is of the view that a 0% VAT will only be applicable in instances where the Acquirer Bank and Merchant are located outside KSA, exceptions to the provisions of Article 33 do not apply and Issuing bank is able to support the above arrangement through adequate supporting documentation.

The location of PNO will not affect the underlying VAT treatment and due consideration should be given to the location of Acquirer Bank and Merchant.

ZATCA clarified that although the interchange fee receivable and payable are often communicated to banks on a net basis, the Issuing bank must determine the gross value of its supplies and report the output VAT as such on these supplies where applicable.

Merchant fee

ZATCA clarified that usually the Acquirer Bank and Merchant are located in the same country, therefore, they should apply the VAT treatment as per the applicable regulations of that country. However, where a KSA based Acquirer Bank is charging fee to a non-KSA based merchant for using Point-of-Sale in KSA, the VAT treatment of such fee needs to be assessed in the light of provisions of Article 33 of the Implementing Regulations as well as other relevant provisions.

PNO charges

Charges levied by PNO such as authorisation, settlement on the Issuer/ Acquirer Banks should be reported under Reverse Charge Mechanism using the gross values (without netting off).

Due consideration should be given to the input VAT proportional deduction calculations where required.

The takeaway

These new guidelines provide information on the VAT treatment associated with some financial service transactions (such as incentives received from international credit card issuers and payment network operators, interchange fee etc).


Banks and financial institutions who perform such transaction are invited to reassess their position (prospectively and retrospectively) in respect to the VAT treatments adopted, evaluate associated risk and seek to benefit from the extended amnesty if applicable. PwC newsalert on the extended amnesty initiative can be accessed [here](#).

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Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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Thank you

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In brief

The Zakat, Tax and Customs Authority ('ZATCA') published a Circular on its official website with an aim to provide guidance on the application of VAT law and its Implementing Regulations on the following transactions involving financial institutions:

Supplies of services by KSA based financial institutions to costumers located outside KSA

laws and provisions concerned with certain supplies of services in the financial sector and their application in specific circumstances.

The Circular can be accessed [here](#).

In detail

The Circular provides clarification on how the VAT rules will be applied on the following supply transactions involving banks and financial institutions in the Kingdom of Saudi Arabia:

- a. Supplies of services by KSA registered banks to non-resident customers; and
- b. Incentive provided by credit card companies to banks in return for achieving operational targets.
- c. Interchanged services

Supplies of services by KSA registered banks to non-resident customers

The Circular provides the principles that should be considered by suppliers to determine the VAT treatment of a particular supply. Depending on the circumstance, such services may either be considered as:

- a. Subject to 15% VAT - financial services where consideration payable in respect of the services is by way of an explicit fee, commission or commercial discount and other supplies of services (unless subject to zero-rated or exempt)
- b. Subject to 0% VAT - supplies of services to a non-resident customer, provided that none of the exclusions from Article 33 apply
- c. Exempt - Financial services where consideration payable in respect of the services by way of an implicit margin or spread.

In the circular, ZATCA provided examples and clarifications for each of the exclusions under Article 33 of the Regulations which taxpayers may use as guidelines in order to apply the existing VAT rules to apply zero rate on supplies.



ZATCA provides specific examples in the circular which banks and other financial institutions can refer in order to apply existing applicable VAT rules





In detail

Incentive provided by credit card companies to banks in return for achieving operational targets

The VAT treatment will depend on the contractual and commercial arrangements between the parties and would typically constitute either:

- a. Supply of service by the bank to the credit card company - In case the bank agrees to perform certain activities for the benefit of the credit card company in return for the payment

In this case, the bank should issue an invoice in relation to the supplies provided to the credit card company.

- b. Reduction of the consideration for earlier supplies by the credit card company - In case there are no services performed provided by the bank and the credit card company merely granted commercial discount on the earlier supplies provided with respect for meeting predetermined volume targets.

In this case, the credit card company should issue a credit note to reflect the adjustment to the consideration of the original supplies.

Interchanged Services

Interchange fees are amounts paid by the Retailer's bank (acquirer bank) to a card holder's bank (issuing bank) for the service provided by the issuing bank. In the transaction, there are five parties involved:

- a. Cardholder
- b. Retailer/Merchant
- c. Issuing Bank
- d. Acquirer Bank or POS Bank
- e. Payment Network Operator (PNO)

In line with this, ZATCA provided examples and clarifications on what is interchanged services, how it is being applied in the banking sector and how it should be treated from KSA VAT perspective if the parties involved are KSA VAT registered or located outside KSA.