Kingdom of Saudi Arabia: FAQs on the recent VAT rate increase

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In brief

On 11 May 2020, the Government of the Kingdom of Saudi Arabia ('KSA') announced several measures to counter the financial and economic impact of COVID-19 on the government budget. Such measures include a reduction in capital expenditures, discontinuation of the cost of living allowance and an increase in the VAT rate to 15%. The announced increase in VAT rate would be applicable from 1 July 2020.

Further guidance on the VAT rate increase was issued by GAZT on 20 May 2020 in relation to the transitional rules that will apply. The recent guidance also sets out that the transitional period for the VAT rate increase would be from 11 May 2020 to 30 June 2021.

Although, the necessary legislative changes have yet to be announced, the recent guidance issued by GAZT will be helpful for businesses as they begin to prepare for the VAT rate increase.

Frequently Asked Questions ('FAQs')

1. Following the recent announcement by the Saudi Government on the increase in VAT rate, what do we currently know?

On 11 May 2020, the Saudi Government announced that there would be an increase in the standard rate of VAT in KSA from 5% to 15%. Further guidance was issued by GAZT on 20 May 2020 on the transitional rules that will apply. In summary, this measure will mean that from 1 July 2020:

- The supply of all goods and services in KSA by taxable persons will be subject to VAT at 15% (rather than the current standard rate of 5%), unless where it is specifically exempt or zero-rated as per the KSA VAT legislation
- The purchase of goods and services in KSA will be subject to VAT at 15% (rather than the current standard rate of 5%), unless where it is specifically exempt or zero-rated as per the KSA VAT legislation
- The import of goods into KSA will be subject to VAT at 15%, unless where it is specifically exempt from VAT as per the KSA VAT legislation

2. Is the change in VAT rate a permanent measure?

There is no indication that this measure will be temporary based on information available to date. Therefore, it is expected that the proposed increase in the standard rate of VAT would be permanent, subject to further clarification by the KSA authorities.

3. Will other GCC countries also be increasing their VAT rate?

Together with KSA, the United Arab Emirates ('UAE') and Bahrain are currently the only two other GCC countries that have implemented VAT.

The UAE Ministry of Finance announced last week that there is no intention to increase the VAT rate in the UAE. No formal announcements have been made by Bahrain.

4. What will be the impact on inter-GCC transactions?

At this stage, GCC states are not treated as Implementing States for the purposes of applying the GCC VAT Framework Agreement. Supplies of goods/services from KSA will be treated in the same manner by other GCC countries as if the goods/services were received by a non-GCC Implementing State. The broader impact of the VAT rate increase on intra-GCC trade is still to be assessed, notably with regards to the difference in VAT rates across the GCC and potential associated compliance burden and distortionary impact.

5. What is the VAT treatment of a supply that is made after 11 May 2020 but before 30 June 2020?

As set out in the recently published Guide by GAZT, where a supply is made on or before 30 June 2020, this supply will be subject to VAT at 5%.
There are special transitional rules in place, as set out by GAZT in the recent guidance, where supplies are made over a period of time, the VAT rate change (please see below).

6. Are there special transitional rules in place for government contracts?

Yes, the recent GAZT guidance sets out special transitional rules for government contracts. Where you have such contracts in place, you will need to consider the dates when (1) the contract was signed and (2) the date when the supply would be made.

As a general note:

- Contracts signed prior to 11 May 2020 would be subject to VAT at 5% until the earlier of:
  - The expiry date of the contract,
  - The renewal date of the contract, or
  - 30 June 2021
- For contracts which are signed after 11 May 2020, the taxable person will need to consider when the supply is made:
  - Where the actual supply is made on or before 30 June 2020, the supply would be subject to VAT at 5%
  - Where the actual supply is made after 30 June 2020, the supply would be subject to VAT at 15%.

7. I have a number of non-government contracts in place that were signed prior to 11 May 2020 where the supplies will be made after 1 July 2020. What will be the impact of the VAT rate increase on these contracts?

As set out in the GAZT Guide, where you have signed a contract with a non-government entity prior to 11 May 2020 and the supplies will be made after 1 July 2020 and the customer has the right to deduct the full input tax, VAT would apply at 5% until the earlier of:

  - The expiry date of the contract,
  - The renewal date of the contract, or
  - 30 June 2021

Although not clearly stated in the guidance issued by GAZT, it would be assumed that under a contract signed prior to 11 May 2020, any supplies made after 1 July 2020 would be subject to VAT at 15% where the customer cannot deduct the full input tax.

8. I have signed an agreement with a customer after 11 May 2020 where I will make a supply of goods prior to 1 July 2020 and another supply of goods after this date. What will be the VAT treatment of the supplies that I make?

In accordance with the GAZT Guide, where you make a supply of goods that are delivered to your customer prior to 1 July 2020, this will be subject to VAT at 5%.

Under a contract signed after 11 May 2020, any goods supplied to your customer that are delivered on or after 1 July 2020 will be subject to VAT at 15%.

9. What should I do where I have issued a tax invoice before 11 May 2020 for a supply that I will make after 1 July 2020?

The GAZT Guide sets out that where a tax invoice was issued before 11 May 2020 and the supply would be effectively made on or after 1 July 2020, this supply would be subject to VAT at 5% on the condition that the actual supply would be made before 30 June 2021.

10. I signed a contract with my customer after 11 May and issued a tax invoice before 1 July 2020. What is the VAT treatment of the supply that will be made on or after 1 July 2020?

As set out in the GAZT Guide, under a contract signed after 11 May 2020, where you have issued a tax invoice prior to 1 July 2020 and the actual supply will be made on or after 1 July 2020, the supply would be subject to VAT at 15%.

The Guide also states that where a tax invoice has been issued at 5%, the taxable person should issue an additional tax invoice for the difference in the VAT due.

11. I am making a continuous supply of services under a contract signed prior to 11 May 2020. What VAT rate will apply for services that I provide after 1 July 2020?

The Guide sets out that where you make a continuous supply of services under a contract signed prior to 11 May 2020 with a VAT registrant who has the right to recover VAT in full and the tax invoice has been issued and payment has been received, the full value of the supply will be subject to VAT at 5% up to the earlier of:

the expiry date of the contract, the renewal date of the contract, or 30 June 2021.

Furthermore, the Guide clarifies that where you have a contract signed with an individual before 11 May 2020 for a continuous supply of services where monthly payments are received and monthly tax invoices are issued (e.g. non-life insurance contracts, gym memberships), any payments received or tax invoices issued after 1 July 2020 for supplies made after this date would be subject to VAT at 15%.

12. What should we do if we have signed contracts with customers that have been agreed at the 5% VAT rate?

As an immediate step, it is recommended you review all existing contracts that you have in place. It is important for you to first differentiate between the contracts that have been signed prior to 11 May 2020 and those that have been signed after this date, and identify if the customer has the right to recover VAT in full.

For those supplies that you make after 1 July 2020 that will be subject to VAT at 15%, it will be important for you to determine whether you are able to charge VAT at 15% under those contracts or whether the consideration agreed would be VAT inclusive.

Where the consideration agreed is VAT inclusive or your contracts specifically state VAT will be charged at 5%, you should liaise with your legal team on how to address this issue. Also, it is necessary to engage with your customers to determine if you can charge VAT at 15% from 1 July 2020 (where relevant), and/or if any amendments need to be made to the legal terms in place.

13. Would the change in VAT rate have an impact on the ERPs and other financial systems?

The change in VAT rate could have a potential impact on the whole VAT system life cycle. The VAT rate change in the tax master data, its interaction with other masters such as materials, customers and suppliers and then further movement during the transactions processing involves some complex workflows. It is important to validate that all these workflows are generating correct results and the tax rate is correctly determined for all transactions.

In case of multiple financial systems, it is also important to ensure that the tax related master data is appropriately updated in all the transaction systems/ POS systems.

Further, it is also important that the system generates the correct VAT documentation and hence its important to also validate if the correct VAT rate is displayed on the tax invoices.

14. What immediate change should be made for the VAT IT changes in the systems?

Businesses should review the existing VAT related system documentation such as existing IT Impact Assessment Reports, Transaction Mapping Sheet and the Business Requirement Documents (BRDs). The required rate change should be discussed with the IT and finance teams to access the potential impact on the financial workflows of procure to pay, order to cash and record to report.

Once the assessment is done, the documentation should be updated to reflect the required changes in the system. The IT team should then make the required configuration/ customizations (if required) changes in the system.

In order to ensure that the VAT is determined correctly across all financial flows, its is important to undertake a thorough testing of the workflows to ensure VAT compliance with the requirements.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact one of the tax partners below:

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