

How VAT impacts you

Hospitality and Leisure sector



VAT in the GCC

The 'Gulf Cooperation Council' (GCC) states are preparing for the introduction of a 'Value Added Tax' (VAT) in the region commencing on 1 January 2018. The proposed VAT will be charged on most goods and services at a standard rate of 5% with a limited number of specifically exempt or zero rated supplies.

VAT registered businesses that supply goods and services subject to VAT at the standard 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, input VAT will not be claimable, therefore constituting a VAT cost for these businesses.

VAT impact on H&L companies

In most VAT jurisdictions, supplies of hospitality and leisure (H&L) are considered as taxable under VAT. As such, H&L suppliers are required to charge VAT on their supplies mostly at standard rate and they are entitled to deduct/recover VAT incurred on their expenses.

Over the years, the GCC countries have collectively hosted millions of tourists, with arrival numbers increasing in most destinations. The likelihood in the GCC context is that hospitality and leisure companies will make supplies which would be considered as taxable.

The H&L sector is comprised mainly of the following subsectors: tourism and tour operators, hotel industry, airlines etc. The scope of H&L services under these subsectors is quite broad and may include:

- tour packages
- transportation services
- hotel accommodation services
- restaurant meals
- ticketing fees
- entertainment fees (telephones, television, internet); recreational fees (wedding activities and other functions); and other conferencing activities, exhibitions, etc.)
- service charges
- agency services (acting as an intermediary or principal).

It is important to determine the specific VAT treatment of each of these supplies (revenue streams) to ensure VAT is charged and reported correctly in compliance with the legislation.

Place and time of supply

The H&L industry has evolved over the years, which is partly due to the technological advancements that allowed people to reserve online airline tickets, hotel rooms etc. However, this has made identifying the place where the services are performed and consumed, and the subsequent VAT treatment more complex.

In addition, the technological advancements such as payment by use of electronic cards i.e. credit/debit cards have made identifying the time of supply of the services complicated and as such determination of the tax point a challenge. Usually, VAT on the supply of taxable services is due on the earliest of issuance of an invoice, payment is received (including part payment) or service is performed.

Incentive schemes

Incentive schemes are common in the H&L industry. Different countries have introduced various incentive schemes to promote the H&L industry. For example, Australia, the UK, Malaysia and Singapore have introduced a Tourist Refund Scheme, that allows tourists to claim GST/VAT paid on eligible goods purchased in these countries.

In this case, we anticipate that GCC countries may introduce some form of incentives on certain eligible goods for tourists. The incentives, will ensure that the introduction of VAT in the GCC does not negatively affect the growing tourism sector in some of the GCC countries.

We have highlighted below some of the instances where determining the correct VAT treatment of supplies made in the H&L sector could be challenging.

Arrangements with third parties e.g. travel agents and other intermediaries – Determining the correct VAT treatment of the transactions involving agents. Usually, the VAT treatment of these arrangements will depend on the relationship with the customer such as, a travel agent acting as an intermediary or a principal.

Inbound/outbound tour packages – Usually foreign tour operators offer packages combining several components including accommodation, tour guiding, tour brokerage, transport, etc. Therefore, the tour operators will need to determine the correct VAT treatment for the various components of these transactions.

Tips and service charges – It is common practice in the H&L industry for an extra charge (tip/service charge) to be levied for serving customers in restaurants and hotels. The extra charge is normally accumulated and distributed to the workers in addition to their salaries. Tips/service charges given voluntarily by guests or customers to a hotel's staff as a token of appreciation for services rendered are excluded from consideration for the supply and as such not subject to VAT.

Cancellation, no-shows, refunds etc. – It is common in the hotel industry for guests to cancel bookings or not show up and seek a refund. In such cases, most hotels usually charge a fee. What is the hotel supplying to the guest in return for the fee? Ensuring the correct VAT treatment is applied is crucial in order to avoid disputes with your guests.

Loyalty reward programs and other business promotions and offers – Many hotel chains own a loyalty program that allow guests to earn points and redeem them for discounted or free stays. Determining the correct VAT treatment where the reward scheme allows for points to be redeemed with third party redeemers could be a challenge.

Pre-booking/prepayment arrangements – Determining the correct VAT treatment where deposits are paid in advance or where a deposit is paid as a security and is refundable.

Short term vs long term accommodation – Hotels usually provide short term accommodation (up to 30 days) and for long term accommodation (6 months) to their guests. In most jurisdictions, short term accommodation is taxable while long term accommodation is exempt. This means that VAT incurred on common costs and general overheads will not be fully claimable and would need to be apportioned.

Other ad hoc supplies related to the H&L industry – Complexities around determining the correct VAT treatment of supplies such as currency exchange, recharge of international calls, compensatory payments for breach of contracts etc.

Systems, procedures and people

An assessment of the capabilities of existing IT systems including reservation 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 existing workflows and processes.

In summary

The above is just a sample of the many issues that will impact H&L companies 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 '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.

The expected date for VAT implementation is on 1 January 2018. Given the business complexity and/or the volume of your business transactions, it could take you a substantial amount of time to evaluate every single transaction and to determine the appropriate VAT treatments.

At PwC, we have a strong indirect tax team with many years of experience in VAT matters impacting H&L players, both in the Middle East and abroad, and we are in an excellent position to support you through this transitional period.