

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 VAT 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 (O&G) 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.

Due to the importance of the oil and gas sector in the region, some or all parts of the supply chain could be zero-rated for VAT purposes notably in relation to exploration and production activities. 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.

The scope of O&G services is quite broad and may include drilling services, seismic surveying, pipeline installation and maintenance, leasing of ships, storing and handling services at installations, refinery and warehousing services and sale of feedstock. It will be important to determine the specific VAT treatment of each of these supplies.

VAT recoverability

The exploration phase of a venture may last anywhere up to 8 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 to enable such companies to claim refunds of VAT incurred.

However the tax authorities may disallow such 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 VAT registered (which may be several years later).

A specified time limit is expected to apply in back claiming such expenses and claims are usually limited to input tax incurred only on capital goods held on hand at the time of VAT registration.

This additional VAT cost for the O&G sector may add to the overall 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 businesses making these exempt supplies, no VAT will be charged on the provision of the 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

Businesses that are mainly involved in zero-rated supplies, and notably O&G exporters, are likely to be in a continuous net refund position of VAT input tax credits with the tax authorities. These companies will need to be cognizant of the potential delay in processing these refunds within the first 12 months after the introduction of VAT. Such delays will put added pressure on O&G companies cash flow.

Thus it is imperative to take this and any upcoming significant capital expenditure into account in order to plan and manage the business' cash flow.

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 treatment is also extended to include O&G subcontractors under the Product Sharing Contracts (PSC) may have a significant impact on the industry.

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:

Transfer of goods between O&G companies – It is common practice for O&G companies to enter into agreements with third parties to have their goods ‘transferred’ for processing and/or treated by the third party and then returned. Determining whether these 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 use and then to be re-exported to the country of origin. For example, rent/lease of oil rigs from non-established suppliers into GCC waters. 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 – How costs are recovered, royalties paid and profits divided are stipulated within the PSC. Ensuring the correct VAT treatment is applied is crucial in order to avoid disputes with your counterparties.

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 where these facilities are located in national, GCC or international waters.

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.

Valuation and Tax point of work obligation – Farm out and Farm in transactions involve one party assigning interest in the PSC to another party (third party) for a consideration mainly in the form of upfront cash and future work obligation i.e. drilling a well or incurring specified development and operating costs. Determining the valuation and tax point for such work obligations has always been a challenge.

VAT treatment of deposit on returnable gas containers – Downstream O&G companies sell Liquefied Petroleum Gas 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 may be a contentious issue.

Systems, procedures and people

An assessment of the capabilities of existing IT systems and re-configuration 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 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 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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