



IMPACT OF VAT ON FINANCIAL SERVICES

INTRODUCTION

The member countries of the Gulf Cooperation Council (GCC) have signed a Unified Agreement on VAT containing the majority of the regulation for the operation of VAT. Each of the 6 countries under the GCC will complete the rules with their own VAT laws. As Kuwait is yet to issue its own VAT law, the content in this newsletter is based on guidelines given under the Unified Agreement or common practices followed by other countries.

VAT IN SIMPLE TERMS

- VAT is a consumption-based tax levied on every value addition made at each stage of the product cycle.
- The standard rate of VAT as per the Unified Agreement is 5%.
- Apart from the standard-rated goods there are a few exceptions for zero-rated and exempted goods. Each country will issue the list of such zero-rated and exempted supplies in its VAT legislation.
- Businesses only facilitate in the collection and payment of VAT to the government.
- $\text{Net VAT payable} = \text{Output VAT (due to be paid on sales@5\%)} - \text{Input VAT (already paid on purchases)}$
- In cases where the outcome of this formula is negative, then such net VAT is refundable from the government or can be carried forward in the next VAT return.

FINANCIAL SERVICES IN KUWAIT

Industry Overview

Kuwait has a leading position in the financial industry in the GCC, and financial and banking companies make up more than half of the market capitalization of the Kuwaiti bourse. According to the World Bank, Kuwait is the fourth richest country in the world (per capita),

and has recently seen surges in entrepreneurship and small business start-ups. Concerning Kuwait since no draft regulations are available, no anticipation can be done on the future VAT regime of the financial services. However the main VAT principles should apply.

Specific Considerations

1. Classification: The VAT classification of various products offered by the financial institutions among standard 5% rate, zero-rated and exempt is a complicated one. However, the global trend in this regard as followed by other VAT jurisdictions is that the fee-based services are taxable and margin-based services are exempt. Saudi Arabia and UAE VAT Laws have adopted similar treatment. However, there are certain exceptions to this general rule.

2. Bundles & mixes: Financial institutions often come up with bundled products wherein certain add-ons are provided along with the main product. In such a scenario, each bundle of financial services contains both taxable and non-taxable products. This complicates the process of calculating VAT especially deductibility of input VAT. For example, the margin on financial derivatives in a portfolio is exempt but the investment management fees for the portfolio manager are taxable.

3. Unallocated cost: Another disadvantage of exempt items for financial institutions lies in the loss of right to claim full deduction of the VAT on those unallocated costs. Most of the outsourced services, such as accounting, transaction processing and IT services, are subject to VAT, but are not directly allocable to a single type of supply (i.e. taxable and exempt supplies). Hence, the input tax incurred is not fully deductible, as the services are utilized for both taxable and exempted operations.

4. Cross-border service transactions: Services received by a company from GCC or foreign country in KSA and UAE must be accounted for VAT on reverse charge mechanism.

If the service purchased is allocated to exempt supplies then the output VAT must be calculated on the invoice received and paid to the Tax Authorities while there is no input VAT to be deducted. If the services bought is allocated to taxable supplies then the same amount must be declared as output and input VAT. If the service is not allocable the Taxable Person shall apportion Input VAT deducted in the frame of the input VAT regularisations.

While the services supplied by a company to GCC countries would, if not exempt, be subject to reverse charge by the business customer. Services supplied to foreign countries would be zero-rated.

5. Invoicing: Due to large volume of small-value transactions in financial institutions, compliance with invoicing requirements can prove to be a huge burden, which increase the non-compliance risks. KSA and UAE laws provides for few alternatives available which ease the burden of issuance of invoices. Some guidelines from Tax Authorities should mitigate this burden.

General Considerations

VAT grouping: This is an option wherein related businesses can register as one taxable Person under VAT depending on individual business structure and environment. Before exercising this option, businesses should carefully consider both the expected outcomes and related issues associated with VAT grouping. The financial institutions should be the main users of this mechanism with big advantages if it is properly settled and the group well organized.

Human resources: It is a common practice to provide various facilities to employees in lieu of salary such as accommodation, gifts, perks etc. The levy of VAT on such facilities is a matter of concern for employers.

Contracts: Each business should consider revisiting their existing contracts to update or include the VAT-related clauses.

WHY YOU NEED TO START PREPARING FOR VAT TODAY

A full-fledged, effective, robust and comprehensive VAT implementation takes ample time from planning to execution. Early preparation is recommended as a short time span to implement VAT may result in an enormous burden on the company and its resources.

Our service offerings

VAT IMPLEMENTATION

- VAT Awareness
- Assess Impact on Business
- Gap Assessment of IT systems
- VAT Implementation
- Ongoing Compliance Services
- Technical Consulting

Post implementation VAT subscription

In the frame of this subscription, we provide our clients with constantly available technical support in the frame of a pre-established budgetary framework.

Flash VAT audits

Post implementation, we also perform flash VAT audits on various specific items.

VAT Audit trail and VAT internal manual

The documentation of the VAT audit trail is the most reliable methodology to ensure VAT compliance to avoid systemic risks in case of VAT audit

Customized training

We build specific VAT trainings focused on the activity of the company and on the day to day concerns of the internal VAT stakeholders.

Tax/VAT archiving processes

The tax/VAT archiving processes will become key for the tax/VAT safety of the companies.

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