GCC VAT
An Introduction – Part 1

Roberto Scalia
Chairman of the JIACC Tax Commission
Assistant Professor of Tax Law (University of Bergamo)
PhD and Lawyer (Avvocato)
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1. Introduction

Bahrain, Kuwait, Oman, Qatar, the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia (KSA), which are the 6 countries forming the ‘Cooperation Council for the Arab States of the Gulf’ (GCC), have signed the GCC VAT Agreement (hereinafter, the ‘GCC VAT’) with the purpose of introducing VAT across the GCC.

At the end of the Implementation period, the legal functioning of VAT across the GCC will be mainly relying upon the following sources of Law:

1. The GCC VAT Agreement (hereinafter, the ‘GCC VAT’);
2. The States’ Laws implementing VAT; and
3. The States’ Implementing Regulations of each States’ VAT Law

It is worth to underline that the introduction of VAT across the GCC was strongly supported by the International Monetary Fund (IMF) to disentangle GCC States’ public revenues from heavily relying on natural resources.

This Tax Insight, divided into two parts, is intended to provide a first guidance on the GCC VAT.

1.1. The GCC Legal Context

International investors can be disoriented when dealing with GCC VAT, if not properly advised on the relevant legal context that VAT shall be fitted within.

The legal context is outlined in the Preamble to the GCC VAT Agreement recalling, in the first place, the Charter establishing the GCC (hereinafter, the ‘GCC Charter (1981)’).

The GCC Charter (1981) states that the GCC is an ‘internal market’ (resembling, to a large extent, the EU market) that heavily relies upon general principles (such as ‘non-discrimination’ and MFN clause) and basic ‘economic freedoms’ (of movement, investing capital and establishment).

All such principles and rules are properly developed and implemented within the Economic Agreement (2001) that is also recalled in the Preamble to the GCC VAT Agreement.

These sources of law are at the outset of GCC VAT and represent the legal tool that shall be considered when interpreting the GCC VAT Agreement.

Unlike the EU, where a common Court exists, interpretation stands with the GCC Ministerial Council (whose case-law on VAT is binding on Member States as if it were the Law itself).

Another key aspect that shall be considered in dealing with GCC VAT is its reliance upon the GCC Custom Code and its Rule of Implementation.
1.2. VAT in the UAE and in KSA

The only two GCC States that have been implementing VAT in their legal system, as of today, are UAE and KSA (taken together, the ‘early-implementer’ States).

The early-implementer States have introduced VAT in their internal tax system, as of January 1st 2018. For the time being, the overall legal framework in the two early-implementer States has its backbone in the following acts:

UAE:
(i) GCC VAT;
(ii) UAE VAT Law, and
(iii) UAE VAT Exec. Regs.;

KSA:
(i) GCC VAT;
(ii) KSA VAT Law, and
(iii) KSA VAT Impl. Regs.

Besides these ‘binding’ sources of Law, taxpayers can rely upon wealthy guidance issued by the Tax Authorities of the two early-implementer States with respect to several issues such as, e.g., Registration; Tax Grouping, Real Estate Sector, Digital Economy, etc.

2. An Outline of the GCC VAT

Despite VAT implementation depends on each Member State, the GCC VAT Agreement created a unified set of rules to be embedded in domestic VAT legislation.

GCC VAT applies to Supplies of Goods and Supply of Services provided for by Taxable Persons.

Import of Goods or Services into the GCC are charged 5% while Export of such Goods or Services outside the GCC shall be zero-rated.

Intra-GCC supplies shall be regulated according with the ‘reverse-charge’ mechanism, according to which the supply is zero-rated in one GCC State and ‘reverse-charged’ in the other GCC State.

GCC VAT applies at a unified standard rate of 5% and shall be neutral for Taxable Persons. Neutrality is ensured through the mechanism of deduction of Input VAT from Output VAT.

3. Taxable Persons

VAT applies to supplies of goods and services by a ‘Taxable Person’.
Taxable Persons are natural and legal persons, either public or private, carrying out an ‘economic activity’.

The exploitation of an ‘economic activity’ is further defined as an activity that is conducted in an “ongoing and regular manner including commercial, industrial, agricultural or professional activities or Services or any use of material or immaterial property and any other similar activity”.

Dividing between supplies that are related to ‘economic activity’ and those that are not is crucial, since only in the former case the person can deduct Input VAT (that is: VAT on goods and services bought by the taxpayer).

Conversely, in the latter case, the person is deemed to be a ‘consumer’ and cannot deduct Input VAT.

Example 01
In 2019 (ACo), an Italian manufacturing company, buys a plot of land where to establish a plant, a warehouse and a truck parking area. The plot of land costs 1,000,000 SAR.
In late 2019, (ACo) prepares all preliminary documents and files all the necessary requests to the local authority to obtain all trade licenses and relevant authorisation to build the plant and the warehouse and to create a surrounding parking area.
However, upon a closer analysis of the legal documents, (ACo) decides to sell the property, due to the impossibility of using the area for own’s commercial purposes.
A Saudi company (BCo) decides to buy and pays 1,500,000 SAR.
(ACo), is deemed to be engaged in an ‘economic activity’, since all the preliminary activities (preparing and filing requests for authorisations and licenses) are preliminary and incidental to a ‘profit making’ activity.

Example 02
As in Example 01. In this case, (ACo) retains the plot of land, obtains all necessary trade license and authorisations, build the plant and warehouse and starts producing its product. Due delays in the assembly phase of the final product, (ACo) starts making profits only in fall 2021.
(ACo), is deemed to be engaged in an ‘economic activity’ starting 2019 . The fact that (ACo) does not make profits between the date of establishment and the end of 2021 is irrelevant.

3.1. Public Bodies and Charities

Government Bodies (hereinafter, ‘Public Bodies’) carry out two types of activity:
  (i) activity in their capacity as a public authority; and
  (ii) ‘commercial activities’
While the supplies in the former case – sub (i) – are not within the scope of VAT, the latter – sub (ii) – are within the scope of VAT.

Charities, in general terms, aim at achieving public interest, not with the purpose of gaining profits.
Example 03
As in Example 02, (ACo) pays to the Saudi Arabian General Investment Authority (SAGIA) 2,000 SAR for issuance of an industrial license. The fee paid for the issuance of the industrial license is not subject to VAT since the SAGIA is acting in its capacity as a public authority.

Example 04
As in Example 02, (ACo) donates, once a year, funds to (BCharity) that are used to create hand-made products which are sold at the (BCharity) annual fair. (BCharity) collects funds both from donors and buyers of hand-made products, and destinies almost all of them to needy children (after offsetting costs incurred for organising such event and manufacturing hand-made products). The Supply of goods (hand-made products) is not in the course of an ‘economic activity’ and shall not be charged with VAT.

3.2. Partnerships, JVs and other unincorporated entities

Taxable Persons include “any other form of partnerships”.

Although partnerships are widely perceived as entities devoid of ‘legal personality’, (such as, in Italy, Germany and Austria), in the GCC States’ legal systems, such entities are recognised with legal personality.

As such, partnerships are Taxable Persons. Other form of entities lacking legal personality, such as Saudi Joint Ventures (hereinafter, ‘JVs’), should be considered as not being Taxable Persons.

However, such conclusion could be controversial. The inclusion of other form of unincorporated entities could be controversial as well (consider, e.g., trusts).

Example 05
(ACo) enters into a new deal in KSA with two local partners signing a partnership agreement (named ‘ABC-pship’) with (BCo) and (CCo) and a joint venture agreement with (DCo). The partnership agreement creates a Taxable Person (the partnership itself) while the JV agreement does not create a ‘new’ Taxable Person. The partnership (ABC-pship) shall register as a Taxable Person and be attributed its own Tax Identification Number.

3.3. Holdings and Real Estate Companies

Holding companies are widely recognised across the GCC as a specific type of Company or, better, as companies that – according to the KSA GAZT – provide “management services or financing to group members”.

The GAZT clearly refers to the corporate law concepts, in order to address this issue.
According to the UAE corporate law, ‘holding companies’ are entities engaged in:

(i) owning or participating in the ownership of Joint Stock Companies and LLCs (whether by shares or otherwise);
(ii) occasionally, providing loans, guarantees and finance to its subsidiaries or acquiring the movables and the relevant real estate needed to commence the activity;
(iii) managing its subsidiaries; and
(iv) acquiring industrial property rights, trademarks, industrial marks, royalties and other rights in kind and to lease the same to its subsidiaries or to other companies.

In the light of all the above, holding companies are widely considered as a specific type of entity whose main feature is the type of activity that is, in wide term, a ‘financial’ activity.

However, not all types of holding companies are deemed to be carrying out an ‘economic activity’.

Holdings that are not carrying out an activity on their own or bearing operational costs, in the GAZT perspective are not Taxable Persons, for VAT purposes.

Real Estate ownership is deemed to be an “economic activity” in the GCC context, as clearly stated in Article 3(6) of the EA (2001).

However, ‘real estate’ activity is deemed to be an ‘economic activity’ to the extent that the mere holding of a building (or land) is accompanied with other activities, aimed at improving the land or building itself.

Example 06

(ACo) is an Italian MNE in the fashion sector.
(ACo) wishes to open a ‘flag’ store in a large Mall in Dubai, in 2019, and – upon achieving the targets as per business plan – opening other 6 stores, all around the UAE, in 2020.
According to the expansion strategy, (ACo) expects to open, immediately after 2020, other 18 stores in large Malls based elsewhere in the GCC (Qatar, Bahrain and KSA).
The (ACo) group manages its cash-pooling strategy, within the EU, through a Belgium-based company. The same type of strategy is envisaged as the most appropriate one in the GCC market, that is to say placing the ‘holding’ company for the GCC region in Dubai and managing all financing activities through the Dubai newco.
The Dubai-based Newco is a Taxable Person for VAT purposes.

Example 07

As in Example 06, Marco Rossi, the CEO and sole owner of (ACo), wishes to employ its own wealth (remuneration as CEO) and profits (dividends from (ACo)) to buy apartments and other assets for his own personal use.
In 2020, due to unexpected extra-profits, Marco Rossi, fuels 20,100,000 AED in a newco (BCo) which invests almost its entire capital (namely, 20,000,000 AED) in one luxury apartment in Dubai, one boat and one luxury car. All the assets are used for ‘private’ use (not for business purposes).
Neither Marco Rossi, nor (BCo) carry out an economic activity. Input VAT on the three items cannot be neither offset against any output VAT nor refunded.
3.4. Tax Group

The GCC VAT Agreement provides that each Member State may treat the VAT Group as a “single Taxable Person” in compliance with the rules and conditions put in place for that purpose.

The GCC VAT Grouping regime is limited to entities that are “resident” in one Member State. Branches (or, rather, Fixed establishments) in the state of persons having the main place of business abroad can join a group.

Although the GCC VAT Agreement does not clarify the threshold of the definition of “Tax Group” a definition of “related persons” is provided for. Such definition refers to two or more Persons, one of which has “supervisory or directive control over the others”, holding the administrative power that enables it to influence the business of the other Persons from a “financial, economic or regulatory aspect”.

The concepts behind the notion of ‘related persons’ is echoed in the KSA discipline that applies insofar:
- 50% or more of the capital of each person; or
- ownership or control of 50% or more of the voting rights or value, in both or all persons is held by the same person or group of Persons, whether directly or indirectly.

Being part of a Tax Group does not waive the liability of the members that shall be jointly and severally liable for the Tax Group’s debt.

The choice to be taxed as a Tax Group shall be made by a person that is the “representative of the Tax Group” and the Tax Group shall be attributed a new Tax Identification Number.

Since the members of the group are joined in a Tax Group supplies among them will be disregarded.

Bibliography