

Saudi Arabia completes first quarterly VAT return cycle: Risk areas identified

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The Kingdom of Saudi Arabia (KSA) introduced Value Added Tax (VAT) from 1 January 2018. Those businesses on a monthly tax period have already filed a number of returns since 1 January, while those taxpayers on a quarterly tax period filed their first VAT return due on 30 April 2018.

During the VAT return preparation and review process, a number of common issues were identified across many businesses in the KSA. Some of the key issues identified are summarized below, to enable businesses to assess whether the issues impact them, and if so, how these may be addressed.

1. Recovery of Input VAT using invoices which do not meet the Tax Invoice requirements set out in the KSA VAT Implementing Regulations.
This was by far the most prevalent issue observed, primarily due to a misconception that the General Authority of Zakat and Tax (GAZT) would take a lenient approach to enforcing the Tax Invoice rules. We are aware that the GAZT has already audited many businesses to determine whether they are correctly applying the Tax Invoice rules for purchases made, and have raised assessments and related penalties, where input VAT has been incorrectly claimed without valid Tax Invoices held. Businesses should review their accounts payable processes and ensure that the Tax Invoice rules are applied correctly and consistently, before claiming input VAT.

2. Inadequate number of tax codes within the VAT accounting system to allow for accurate VAT reporting. Many VAT accounting systems were set up with around six tax codes, which for most businesses is not sufficient. A common issue observed has been the use of a single "non-VAT" code to record all out-of-scope, exempt, and zero-rated transactions. Additionally, many businesses have been using a single tax code for both imports of goods and services, which makes the Box 8 and Box 9 reconciliation for the VAT return difficult. Businesses need to ensure that their tax codes allow for adequately tracking and reporting of all types of sales and purchases separately.
3. We observed many businesses performing a number of manual adjustments outside of the system to comply with VAT, requiring complicated reconciliations before the VAT return can be prepared. A review of IT processes including the adequacy of tax codes, as well as accounts payable and accounts receivable processing, should be undertaken to ensure that any systems issues are adequately managed and do not contribute to financial and operational risks.
4. Across VAT groups, there have been many instances of intra-VAT group transactions between group members being treated as subject to VAT, and not excluded as required. Businesses should use separate tax codes for intra-VAT group transactions, as these need to be separately identifiable and must not appear on the VAT return.
5. Some businesses have incorrectly used the adjustments column in the VAT return for under-reported and/or over-reported amounts, greater than SAR5,000 (approx. US\$1333). Only adjustments relating to prior months, with compliant credit notes and debit notes held, should be reported in the adjustments column. An error in reporting from a prior month that is over SAR5,000, must be disclosed to the GAZT separately and dealt with through an amendment to the prior return.
6. Some retailers are still charging VAT incorrectly, with VAT exclusive pricing being displayed, and VAT being added to the price of goods at the point of sale. Prices should be displayed inclusive of VAT. We understand that the authorities are applying this requirement stringently, with on the spot fines for violations.
7. VAT reporting requirements have often been confused with accounting rules. We have observed input VAT being recovered based on accruals, without a valid Tax Invoice held. Similarly, in terms of output tax, we have observed many instances where no consideration has been given to the VAT time of supply rules, with businesses incorrectly declaring output VAT to the GAZT when these amounts are recognized as income from an accounting perspective.
8. There have been a number of instances where VAT from other countries has been incorrectly recovered through the KSA VAT return. For example, United Arab Emirates (UAE) VAT incurred on purchases, being recovered through a KSA VAT return. There appears to be a misconception that, as the KSA and the UAE are both within the Gulf Cooperation Council, this is permitted. As a general rule, only KSA VAT incurred on purchases, should be eligible for potential recovery through the KSA VAT return.
9. A number of businesses importing goods on behalf of other parties due to customs import license restrictions, have attempted to recover the VAT charged on the import. If businesses incur VAT relating to the import of goods on behalf of other businesses, depending on the circumstances, there is a real risk that VAT may not be recoverable by either party based on the GAZT's current view.
10. Additionally, there appears to be some misunderstanding in relation to the requirement to apply the reverse charge to imported services. There have been many businesses applying the reverse charge to every foreign purchase, while others were not using the reverse charge at all. This issue highlights gaps in transaction mapping, and the practical application of the VAT rules at the accounts payable processing point. Businesses which have not done so already, should map their transactions, including foreign purchases, and assess the KSA VAT reporting obligations of each transaction.

11. Input VAT relating to exempt supplies or incurred in relation to expenses such as business entertainment, company cars, private use, mobile phones with non-business use should not be recovered.

However, we have observed that many businesses have not been blocking input VAT on such expenses, as accounts payable teams were often not aware of the requirement.

Businesses should consider a separate tax code for blocked input VAT to ensure it is not recovering these through the VAT return. Businesses should also be reviewing their partial exemption position, where exempt supplies are made.

12. Additionally, we have observed a number of instances where partial exemption calculations were often performed incorrectly, particularly across VAT groups.

Apportionment for the purpose of the calculation should be performed at the VAT Group level, and not the individual entity level.

13. A number of businesses have been incorrectly blocking the recovery of input VAT on the purchase of capital assets.

Input VAT incurred on capital assets can generally be recovered, subject to the normal rules and adjustments for change in use.

14. When processing purchase invoices, some accounts payable teams have been automatically calculating VAT at 5% of the net value of the transaction.

In some instances, this amount did not necessarily correlate with the actual amount of VAT charged by the supplier, as per the Tax Invoice (for example, where suppliers have charged the wrong amount of VAT).

It is important that only the VAT actually charged by the supplier, as evidenced on the Tax Invoice provided, is recovered. If the VAT rate applied by the supplier is incorrect, the supplier should be requested to issue a credit note for the incorrect invoice, and to issue a new invoice with the correct amount of VAT.

Next steps

Before the next VAT returns are due, KSA businesses should address the specific issues noted above and review their VAT compliance requirements and processes relating to:

- ▶ VAT return preparation
- ▶ VAT return reviews
- ▶ Systems reviews and testing
- ▶ Post-VAT implementation health-checks
- ▶ VAT training
- ▶ VAT advisory services
- ▶ Customs and global trade advisory services

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