VAT brief

Real estate & construction

keypoint

The release of the draft Saudi VAT law on 29 May 2017 is an important development in the introduction of VAT in the GCC. Following on from the release of the unified agreement on VAT, which sets out a basic framework for VAT across the GCC but leaves GCC states with discretion in certain areas, key decision makers should now be more aware than ever that VAT is going to be implemented – and that preparation time is short.

What is VAT?

- VAT is designed to be a tax on consumption, not income or profits.
- The GCC countries have agreed a VAT rate of five percent.
- Goods and services can be exempt, zero-rated or standard-rated.
- Registered suppliers will add VAT to the price of a good or service they supply, collect the tax and pay it to the tax authority on a regular basis.
- Registered businesses should (where the supplies they make are either standard- or zero-rated) be able to recover the VAT they have paid as an input tax credit.
- Registered businesses that make supplies that are exempt from VAT will not be able to recover the VAT they have paid.
- Registered businesses that make supplies that are zero-rated will usually be in a refundable position.

How will VAT affect the real estate & construction sector?

- Under the GCC framework, each GCC country has the right to either exempt or zero-rate real estate supplies.
- Articles 15 and 16 of the Saudi VAT law state that the VAT regulations will specify the goods and services that will be exempt and those that will be zero-rated. The Saudi VAT implementing regulations have not yet been released.
- In other VAT jurisdictions, it is common for residential property to be either exempt or zero-rated.
- New residential property is likely to be zero-rated, allowing property developers to claim input tax credits on their purchases.
- Construction services are likely to be standard rated (five percent).
- Commercial property is likely to be standard-rated (five percent).
- Leasing of residential property is likely to be zero-rated while leasing of commercial property is likely to be standard-rated.
- Exemptions will add costs to supply chains (possibly for both the developer and the real estate owner) as VAT paid by registered businesses that make exempt supplies will not be recoverable.
- Businesses that are developing both commercial and residential real estate will need to correctly identify and allocate input costs to maximise their claim for input tax credits.
- Long-term contracts (both construction and leasing) that span the introduction date of VAT will need to be reviewed to ensure VAT can be passed on to the customer.
- The timing of accounting for VAT could pose a significant cash flow issue. Typically, VAT is accounted for at the earlier of the supply being made or invoice date – so VAT may be payable to the tax authority a long time before payments are collected from customers.
- Special rules may apply to the construction sector in relation to progress claims that a constructor or developer demands from their customers.
- Different VAT treatments may be applied to mixed use – both commercial and residential – properties.

What still needs to be clarified?

- Will residential property be zero-rated or exempt?
- Will there be a difference between first supply of residential property and subsequent sales?
- Will governments allow the construction and real estate sector to delay payment of VAT ?
- How will mixed-use properties be assessed for VAT?

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Please visit our website keypoint.me to read more about how VAT may affect the real estate & construction industry in Bahrain and the wider GCC.