VAT Alert

October 2018

KINGDOM OF SAUDI ARABIA

KSA Guide: Input Tax Deduction

Introduction

The General Authority of Zakat & Tax (GAZT), Kingdom of Saudi Arabia (KSA), has issued guidelines addressing the concerns and clarifications on Input Tax Deduction under the KSA Value Added Tax Law and Implementing Regulations. This alert summarises the key points for your easy reference.

Categories under which Input Tax can be claimed

- Value Added Tax (VAT) charged by the Supplier on Goods or Services Supplied in the KSA
- VAT under Reverse Charge Mechanism (e.g. VAT on import of services)
- VAT on Imports paid at customs (Only the importer on record can claim credit)

The guide has touched upon certain points which needed further clarity

1. Under certain circumstances, the customer is eligible to take the credit of Input VAT even though beneficiary is third party: e.g. An employer (customer) enters into a contract with a private health company (supplier) to carry out health checks on all employees (beneficiary) working at a site to meet its workplace safety requirements.

The employer would be able to deduct the VAT on invoice charged by the private health company.

2. Customer would not be able to deduct VAT if it is charged incorrectly or without a legal basis. Thus, in order to be eligible to deduct the input VAT credit, the customer may be assumed to own the responsibility to prove that VAT has been correctly charged by the supplier. e.g. if the supplier has charged VAT wrongly on any exempt supply on its invoice which has been paid also by customer, the deduction of the input VAT will not be available.

3. The deduction of VAT paid on imports is available to the importer on record as reflected in the import documentation. In case, if the taxable person imports the goods through a third party or agent who acts as an importer on record, the deduction of VAT paid shall not be available as the taxable person is not the importer on record. Similarly, the deduction will also not be available to such third party or the agent, as they have not paid such VAT for their economic activity.

Eligibility for the deduction of Input Tax

A Taxable Person is eligible to deduct Input VAT paid on goods and services purchased or imported for carrying out its economic activity in the course of making Taxable Supplies.

It is vital as per the Unified Framework Agreement, KSA VAT Law and Implementing Regulations that the correct documents to support the Input Tax deduction claim by a Taxable Person are provided such as:

- A Tax Invoice in case of local supplier
- Proof of payment of VAT at customs & relevant import documents in case of import of goods
- Invoice/ relevant document evidencing receipt of service from a foreign supplier

Example: A company is manufacturing furniture; the company buys wood logs from a supplier and the VAT paid by the company to the supplier for buying wood logs can be deducted as Input Tax.

According to the KSA Implementing Regulations, the following alternate documents should be provided to support the Input Tax Deduction in case the specified documents are not available**:**

- Simplified Tax Invoice according to the KSA VAT Implementing Regulations

- In the case of a Supply arising on the transfer of Goods to another Member State, a commercial or other document substantiating the value on which VAT is calculated at the transfer date
- Commercial documentation validating that the Taxable Person has received the supply and correctly incurred the VAT

Ineligibility for the deduction of Input Tax

Input Tax cannot be claimed by a Taxable Person if it is incurred for non- taxable activities which can be divided into two categories

- Exempt activities
- Non-economic activities (e.g. For private use or enjoyment of business owners/employees)

Further, following are deemed to be Non-economic activities

- Any form of entertainment, sporting, or cultural services;
- Catering services in hotels, restaurants, or similar venues;
- Purchase, lease, repair, fuel of restricted motor vehicles (which is open to private use)

Example: A company hosts a function for an employee’s birthday. It is not considered an economic activity and the VAT incurred on the food and catering for the function cannot be deducted as Input Tax.

Vendor invoice not in Arabic

The KSA VAT Law and Implementing Regulations state that all invoices should be provided in Arabic. The guide for Input Tax Deduction extends the purview of a “valid tax invoice”, whereby the invoice in any language other than Arabic may also be considered by the Authorities at their discretion. The following criteria is essential for exercising the right to deduct input tax:

- The invoice meets all invoicing requirements listed in the Implementing Regulations other than being issued in Arabic
- The Taxable Person has other evidence that VAT has been paid to the supplier (bank statement, receipt from the supplier), and
- Upon request by GAZT, the Taxable Person must provide a certified translation of any invoice if required during an examination or for any other reason

Deduction of Input Tax by a Taxable Person in a subsequent period

The KSA VAT Implementing Regulations provides the flexibility for the deduction of Input Tax in a later period. Input Tax according to the KSA VAT Implementing Regulations can be deducted at any time within the period of five years from the calendar year to which the supply relates.

Adjustment of Input Tax Deduction

In certain scenarios, there may arise a need to adjust the Input Tax, such as:

- Change to the consideration payable
- Non-Payment to the supplier
- Adjustment of Input Tax Deduction for Capital Assets as per the KSA VAT Implementing Regulations and KSA VAT Law

It is essential for a Taxable person to determine and assess the adjustments that are to be carried out for the purpose of deducting the Input Tax. No adjustment is required in case of theft, damage, or loss of goods provided that the theft or loss is recorded in the books of accounts and sufficient documentary evidence is kept, e.g. police report/ insurance claims etc.

Proportional Deduction of Input Tax and apportionment

Proportional Deduction: As per the KSA VAT Law and VAT Implementing Regulations, Input Tax incurred by the Taxable Person related to the Taxable Person's VAT non-economic or exempt activities cannot be deducted as Input Tax. A Taxable Person engaged in both taxable and exempt supplies can only claim Input Tax deduction which relates to the taxable supplies.

Apportionment between Economic and non-economic activity:

- Input VAT deduction is available to the extent it is incurred in the course of an Economic Activity.
- If a Person carries out both an Economic Activity and a non-economic activity, the Input Tax deduction should be determined on the basis the supply made by the taxable person in the course of carrying out their Economic Activity.
- Companies must partially reverse Input VAT on common expenses w.r.t incomes which do not qualify as economic activity.

E.g. A Company engaged in the manufacturing of goods and is also earning income in the form of donations or charity, the Company is required to apportion the common expenses towards the taxable and non-economic activity and will have to adjust the Input Tax deduction accordingly.

Apportionment between Taxable and Exempt supplies:

- VAT incurred which relates to a Taxable Person’s exempt activities, namely financial services e.g.as interest income or residential rental etc., is not deductible as Input Tax.
- The Taxable Person making both taxable and exempt supplies is only allowed to deduct the Input Tax related to the Taxable Supplies.
- Taxable persons who make both exempt and taxable supplies must determine the deductible Input Tax available to them.

Following table illustrates the deductibility of VAT input in above mentioned scenarios

<table>
<tr><th>Scenarios</th><th>Input Tax relates to the Taxable Person’s economic activities</th><th>VAT relates to the Taxable Person’s non-economic activities</th><th>VAT relates partly to economic and partly to non-economic activities</th></tr>
<tr><td>VAT directly attributed to Taxable Person’s taxable supplies</td><td>Deduct in full</td><td rowspan="3">No Deduction</td><td rowspan="3">Partial deduction to the extent VAT relates to economic activity and Taxable Supplies</td></tr>
<tr><td>VAT directly attributed to Taxable Person’s exempt supplies</td><td>No Deduction</td></tr>
<tr><td>Overheads and all other Input VAT that cannot be directly attributed</td><td>Partial deduction based on apportionment</td></tr>
</table>

Input Tax Deduction on incidental activities

There may be expenses relating to business which are incidental to the business and do not form a part of the Taxable Persons usual economic activity. The following criteria provided in the KSA VAT Implementing Regulations is essential for qualifying as incidental activities:

- Raising capital for an ongoing Economic Activity by way of issue of share capital or debt
- business activity which is treated as outside the scope of VAT
- one-off event which is incidental to the Economic Activity for making Taxable Supplies

Comments

- Taxable Persons not only need to be aware of the KSA VAT Law and Implementing Regulations while claiming the Input Tax from the Authorities and the Government, but also extra caution needs to be exercised for claiming the deduction of input VAT. Also, businesses need to be careful whilst negotiating with their suppliers so that any disallowance of deduction of VAT does not become the cost of the business in case of fault of the supplier.
- The guide has provided the clarity on the VAT incurred by business under few circumstances where it is not a beneficiary. This analogy may be applied to all such scenarios where VAT is incurred by businesses, not being the beneficiary by itself to claim the deduction of input VAT.
- All the calculation methods for adjusting and apportioning the Input Tax are provided in the guide for Input Tax deduction issued by the GAZT as well as the KSA VAT Law. Businesses need to be judicious about the nature of expense on which VAT has been incurred which needs apportionment, thus requires robust internal controls in place. Businesses also need to make their IT systems robust and configure them in such a way so as to get the segregation of figures of expenses and VAT incurred for the purpose of accurate computation of VAT available for deduction and reversal.

Incorrect claims of Input Tax may attract penalties which are as high as three times of the value of goods/ services involved. It is crucial for a Taxable Person to be judicious and keep a record of all the documents for claiming the Input Tax deduction.

W T S Dhruva Consultants

Bahrain
Bahrain Financial Harbour,
East Tower,
Office 2301, Building 1398,
Road 4626, Block 346
Manama, Kingdom of Bahrain
Tel: +973 1663 1925

UAE
U-Bora Tower 2,
11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel: + 971 569005849

Dhruva Advisors

Mumbai
1101, One India Bulls Centre,
11th Floor, Tower 2B,
841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400 013
Tel: +91 22 6108 1000 / 1900

Ahmedabad
B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad - 380 015
Tel: +91-79-6134 3434

Bengaluru
Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560 001
Tel: +91-80-4660 2500

Delhi/NCR
101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana - 122 002
Tel: +91-124-668 7000

New York
Dhruva Advisors USA, Inc.
340 Madison Avenue, 19th Floor,
New York,
New York 10173 USA
Tel: +1-212-220-9494

Silicon Valley, USA
Dhruva Advisors USA, Inc.
5201 Great America Parkway,
Santa Clara,
California 95054
Tel: +1 408 930 5063

Singapore
Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05,
Singapore - 049319
Tel: +65 9105 3645

Contacts

Dinesh Kanabar
Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com
Phone: +91 22 6108 1010/11

Pratik Shah
Resident Partner & VAT Expert
pratik.shah@dhruvaadvisors.com
Phone: +971 55957 8232

Nimish Goel
Resident Partner & VAT Expert
nimish.goel@dhruvaadvisors.com
Phone: +971 50106 6531

Nilesh Ashar
Resident Partner & VAT Expert
nilesh.ashar@dhruvaadvisors.com
Phone: +971 50106 6531

Gaurav Khurana
Executive Director, KSA & Bahrain
gaurav.khurana@dhruvaadvisors.com
Phone: +973 3442 3043