VAT in the GCC

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VAT and the GCC

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- In June 2016, the Finance Ministers of the six GCC member-states approved a Value Added Tax (VAT) treaty following an extra-ordinary meeting in Jeddah, which focused on GCC economic integration. VAT – an indirect tax on consumption – is expected to be levied on most goods and services across the GCC at an initial rate of 5%.
- The concept of implementing VAT in the GCC region is not entirely new. GCC governments – namely UAE, Saudi Arabia, Qatar, Oman, Kuwait and Bahrain – have been discussing the idea since 2007, following recommendations from the International Monetary Fund (IMF). This treaty now ensures that the GCC countries will move in relative tandem, subject to internal ratification of the VAT laws in their respective jurisdictions. However not all of the GCC member states are likely to all be ready to implement this new tax on January 1st 2018, due to differences in their domestic legislative processes.
- Currently, there are various forms of levies and charges that can be regarded as "indirect taxation" in the GCC. These include airport taxes, visa fees, municipality fees, toll gates, utility taxes, and property transfer fees. There are also direct taxes, primarily on imports.
- Given the significant drop in hydro-carbon revenues since 2014, a new revenue stream is needed to help diversify funding sources, hence the introduction of VAT. This specific tax remains a tried-and-tested model and will definitely raise the benchmark for GCC economies.

GCC Countries: Breakdown of Pre-VAT Tax Revenues (in percentage of non-oil GDP)

	Total	Personal Income	Corporate Income	Goods & Services	Trade	Property	Other
Bahrain	0.80	…	…	…	0.80	…	0.00
Kuwait	2.20	…	0.50	…	…	…	1.70
Oman	6.00	…	3.00	…	1.60	…	1.40
Qatar	3.80	…	2.50	…	0.80	…	0.50
Saudi Arabia	2.30	…	0.80	…	1.50	…	0.00
UAE	3.50	…	0.80	…	0.60	…	2.10

Source: NBAD Global Markets estimates; IMF.

Why now?

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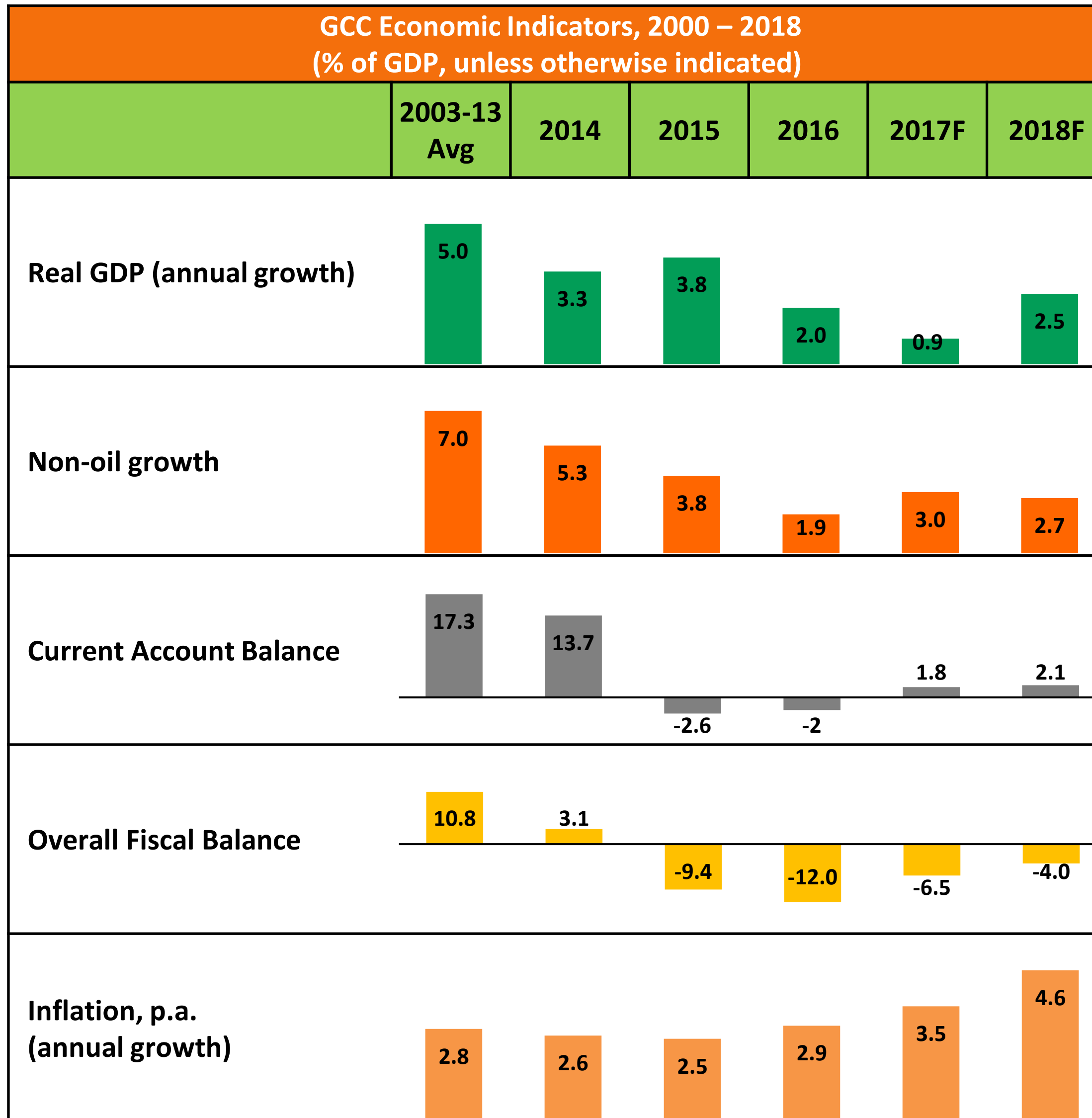

Source: NBAD Global Markets; IMF estimates.

- In 2016, GCC oil revenues constituted approximately 58.8% of government revenues and the region is estimated to have registered a fiscal deficit of 12.00%.
- In 2017, we anticipate oil revenues to constitute 58.5% of GCC government revenues, and the region will register a fiscal deficit of around 6.5%. This highlights the GCC's continued high reliance on oil revenues and vulnerability to commodity price swings.
- For the GCC overall, the crude price required for fiscal 'break even' at 2016 expenditure levels was approximately US$75.
- As of 2016 year end, GCC states' net foreign assets stood at nearly 2.5 trillion USD. GCC member states have witnessed a depletion of 415 billion USD in collective net foreign assets since Q3 2014. Notwithstanding the ability of these countries to sustain fiscal deficits in the short term, the introduction of VAT will help governments narrow their existing fiscal deficits.
- Given current demographics, consumers in Saudi Arabia, Oman, and Bahrain will be much more sensitive to VAT and we forecast an incremental reduction in consumer expenditure in these geographies. On the other hand, the economies of the UAE, Kuwait, and Qatar will be more resilient.

To what extent will VAT revenues help to plug the fiscal gap?

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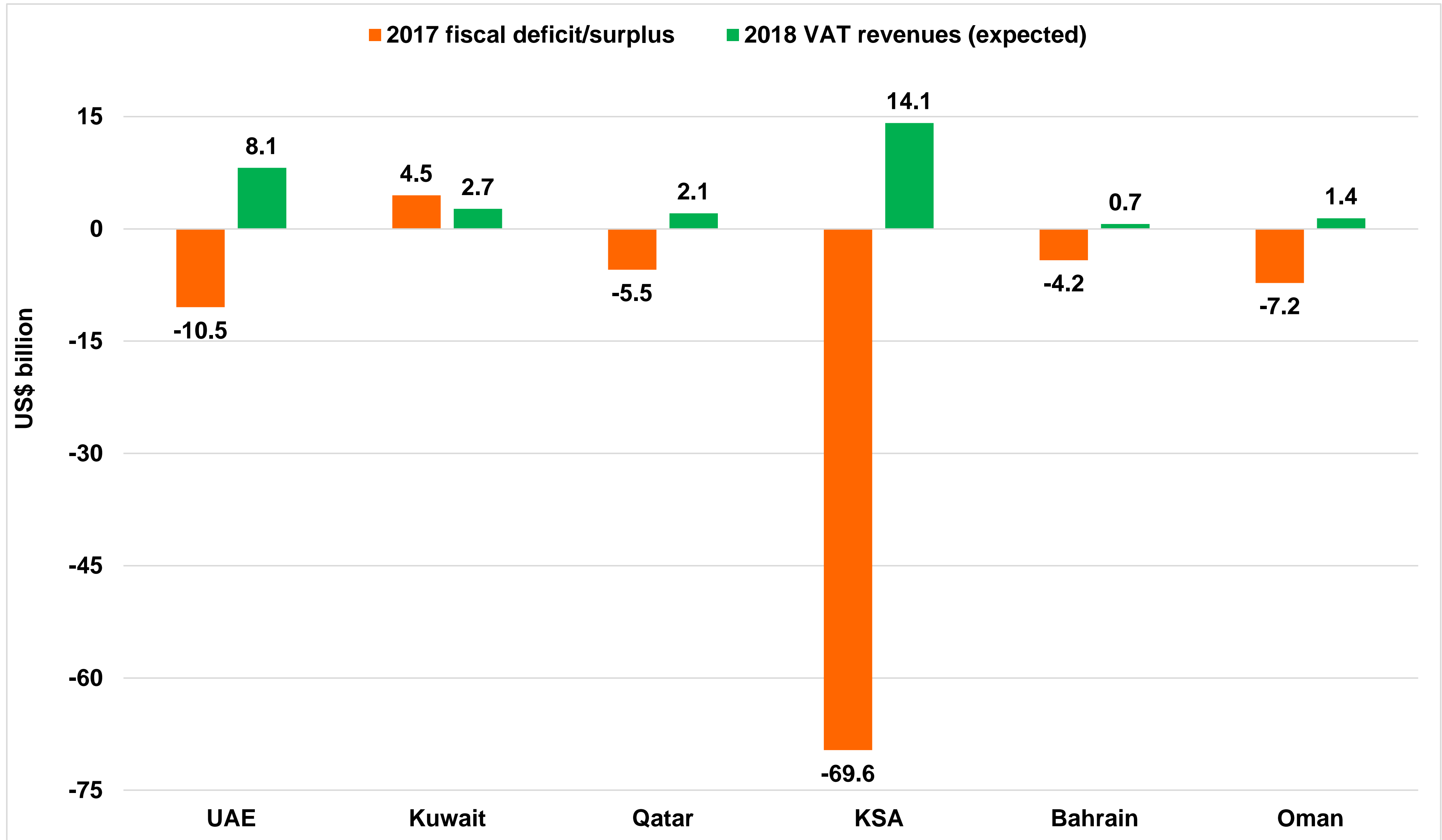


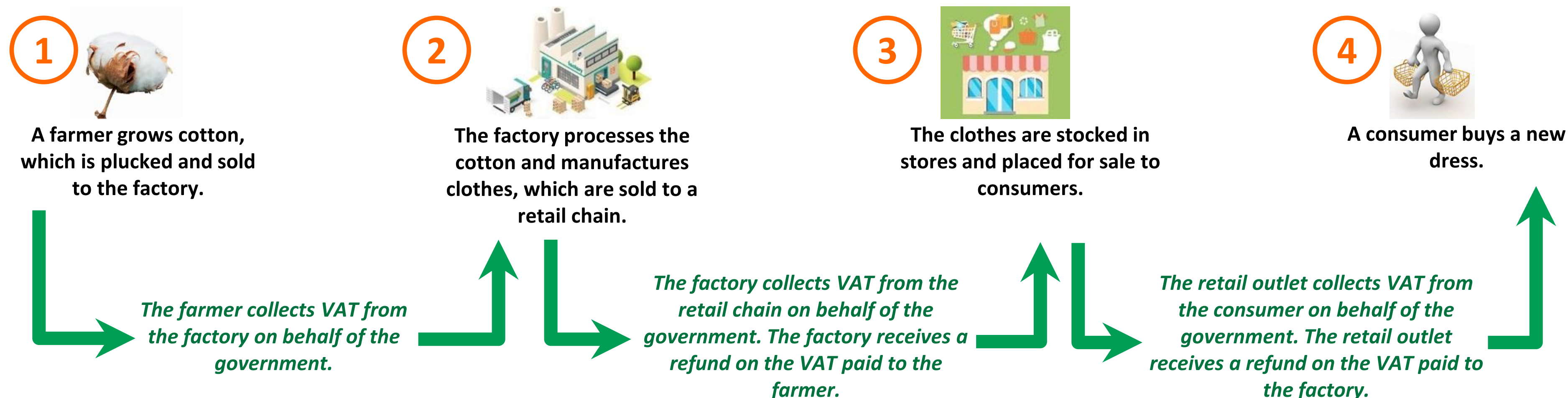
Source: NBAD Global Markets estimates; IMF.

How will it affect GCC citizens and residents?

- There remain a number of key policy decisions to be taken by the six GCC governments, including the introduction and ratification of the respective VAT laws. VAT implementation is expected to be introduced in a phased manner, initially targeting larger companies with annual revenues over a certain threshold in each jurisdiction.

- The majority of the GCC consumer basket is unlikely to see any significant price changes as a direct impact of VAT. The direct inflation impact on lower and middle income households is expected to be muted, with higher-income brackets absorbing the inflationary expense through various discretionary spending mechanisms, including retail purchases, restaurant bills, and telecommunication bills. The following will most likely be tax-exempt or zero-rated: residential property sales and leases, exports, healthcare-related expenses, and education.

- Below is a simplified VAT example of a fabric sale in the UAE across the value chain:



	Sales	5% VAT charged on Sales	VAT recovered on purchases	Net VAT payable
Farmer	AED 1,000	AED 50	AED 0	AED 50
Factory	AED 3,000	AED 150	AED 50	AED 100
Retailer	AED 5,000	AED 250	AED 150	AED 100
			Net VAT paid by final consumers	**AED 250**

Source: NBAD Global Markets; UAE Ministry of Finance.

The road ahead

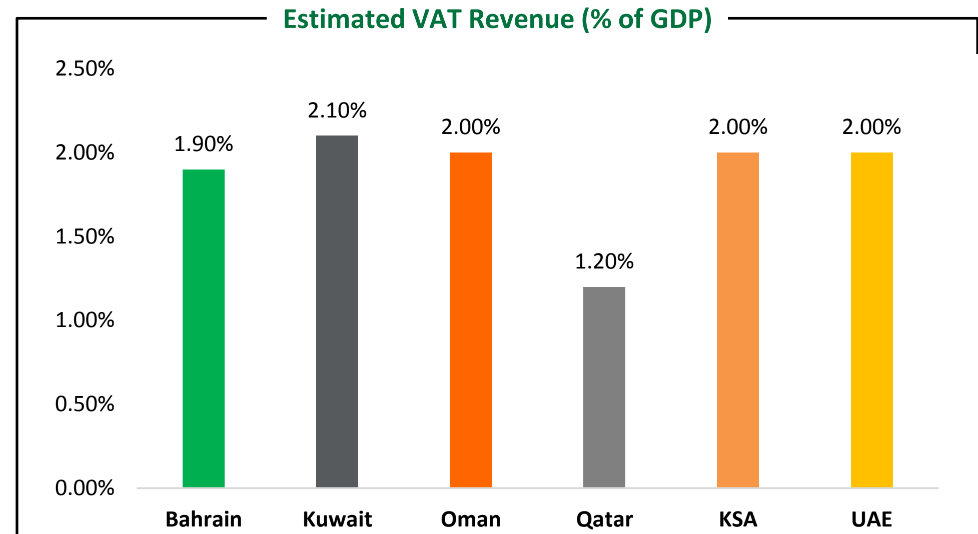
- The implementation of VAT will assist in revenue generation – ranging between 1.20% to 2.10% of GDP across GCC member states. However, in its current proposed form, it may be insufficient to address fiscal deficits in the longer-term – particular when the introductory rate of 5% is held in juxtaposition to other countries.

- Further tax reforms may be necessary, including a gradual increase in the VAT rate, as well as the introduction of new taxes on corporate and personal income.

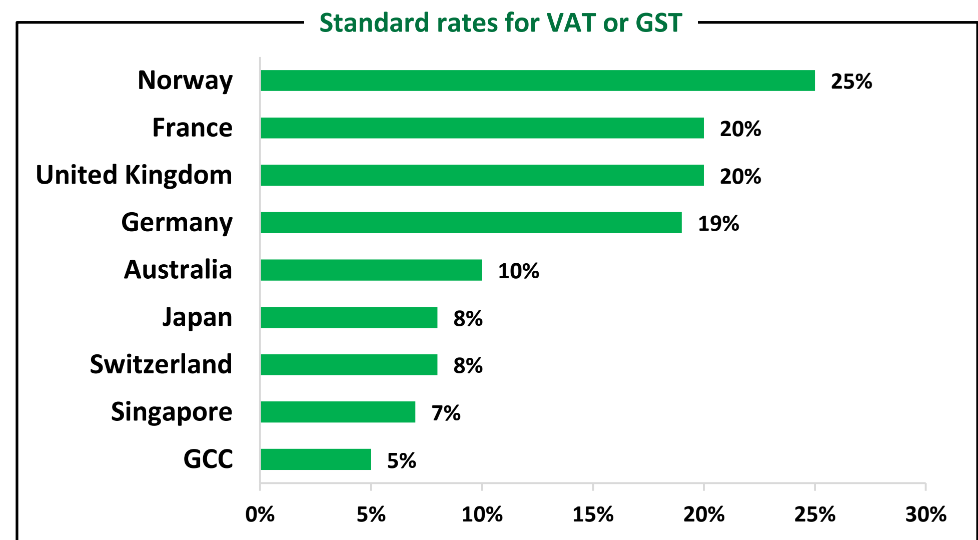
- However, increasing the tax burden in the region must be weighed against any adverse consequences, including a decrease in appetite coming from foreign investors and skilled foreign workers in the region. Tax dynamics must factor the implications of foreign human capital, as expatriates play a critical role in the region's economy.

- Broader economic reforms may be necessary as the VAT and tax amendments alone may prove to be insufficient on a standalone basis. Pro-growth policies, including trade, investment, and labour market liberalization, may be necessary to increase competitiveness in the region.

- Like VAT, economic reforms should be coordinated at the regional level between all GCC member states to ensure mutual interest and compel collective action and enforceability.



Source: NBAD Global Markets; IMF.



Source: NBAD Global Markets; National tax authorities.

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