VAT IN KSA

ITS IMPACT ON THE HOSPITALITY SECTOR

An in-depth look at the latest tax legislation in KSA, what industry players can expect and how to prepare, by **Chadi Chidiac**, managing partner of PROTOCOL

The Gulf Cooperation Council (GCC) states are preparing for the introduction of a Value Added Tax (VAT) in the region starting January 1, 2018. The proposed tax will be charged on most goods and services at a standard rate of five percent, other than limited, specifically exempt and zero-rated supplies. Businesses registered offering goods and services at the standard or zero rate are usually entitled to claim a credit for VAT incurred on their business expenses or input VAT.

The Gulf Cooperation Council Unified Agreement for VAT and Excise Tax is the framework through which GCC member states will implement their own tax, excise tax and regulations at national legislation level. Member state ratifications, such as that undertaken in Saudi Arabia on January 30, 2017, represent one of the final stages before the taxes are applied. The publication of the draft tax law is an important step for the Kingdom en route to a trouble-free implementation of the new tax, in line with its efforts to improve communication with taxpayers, while creating public awareness.

The law in effect

The excise tax law became effective on June 10, 2017, in KSA on key items, namely energy drinks and tobacco derivatives, at 100 percent, and soft drinks and carbonated water at 50 percent. Input VAT cannot be claimed on supplies of exempt goods and services, meaning that this constitutes a tax cost for these businesses.

When it comes to the impact of VAT on companies in the hospitality and leisure segment, there are important issues to note. In most tax jurisdictions, hospitality and leisure supplies are considered taxable. As such, industry players in this area are required to charge VAT on their supplies, mostly at standard rate. They are also entitled to deduct or collect VAT incurred on their expenses. Over the years, GCC states have collectively welcomed millions of visitors, with arrival numbers still surging in most destinations. The likelihood, therefore, in the GCC context is that hospitality and leisure companies will be producing supplies which will be considered as taxable.

The hospitality impact

The hospitality and leisure arena includes a range of subsectors, such as tour operators, hotels and restaurants, and airlines. The scope of their services is broad, encompassing:

- Tour operators and packages
- Transportation
- Hotel accommodation
- Restaurants
- Ticketing fees
- Entertainment and utility fees, such as telephones, television and internet
- Recreational fees, such as weddings
- Conferencing activities, such as exhibitions
- Service charges
- Agency services (acting as an intermediary or coordinator)

Thus far, the purpose of introducing VAT remains unclear. Personally, I believe that implementing it simply to plug the gap in the deficit makes no sense, since the bottom line will reach no more than three percent of GDP. Rather than seeking short-term profitability, it will be more beneficial to focus on putting in place sound institutional government structures for the long haul. In brief, recalling the experiences of some other markets, while the benefits of VAT might have included additional income for the authorities, the tax has also helped to produce a greater level of transparency across the business environment. To give just one example, an organization will immediately have to put regulatory structures in place to report these numbers, which, in turn, will boost the financial and operational infrastructure of the business.

The first impression we receive when spending time with hospitality communities across the region is that they feel the new tax legislation will undoubtedly make a difference to their operations in terms of pricing policies and operational process. However, given that VAT will be set at an introductory rate of five percent, well below that of countries such as the UK, (20 percent), and Lebanon (10 percent, possibly rising to 11 percent), the sentiment seems to be optimistic. Several operators are confident that their business will feel no adverse effects and are keen to better understand how VAT will operate in KSA.

Further down the road and nearer to January 2018, additional measures and modifications will need to be implemented by hoteliers and hospitality operators in order to be VAT ready. It is imperative that they set up the necessary system for VAT, ensuring that management charge it and that suppliers are VAT-registered, by revising all certifications. Industry players must bear in mind that extensive training will be required, with processes much more complex than simply adding five percent to an invoice. Businesses will typically need between a year and 18 months to become VAT ready. Within your organization, it's your responsibility to adopt a whole new mindset. The first step is to recognize that VAT brings additional costs, as well as income generation. The second is to be aware that there is now a regulatory requirement by which all stakeholders inside the organization must abide.

How to be VAT ready

There are several steps that companies need to take in order to be well prepared for the new tax:
1. Look internally at the data-processing circuit.
2. Examine all procurement channels, regulations and policies, the contracts that are in place, the payment methods and facilities, as well as all agreement terms. If you have contracts that roll over to 2018, you are going to have to amend them.
3. IT systems must be a priority. They will need to be completely updated and transformed into VAT-compatible systems.

When the 10 percent sales tax was introduced across Dubai hotels, operators were obliged to access a portal and familiarize themselves with it.

Consumers still testing ground

The challenging economic conditions in 2016 weighed on Saudi consumers, a trend particularly pronounced in the restaurant and hotel segments. However, a recent ground survey executed by PROTOCOL showed a recovery in sales for the first quarter of 2017, up 10 to 15 percentage points.

With a struggling economy producing a plateau in sales, GCA has plunged sharply. Indications are that eating at home, rather than venturing out to restaurants, is a preference for many, according to PROTOCOL's key performance indicator (KPI) of sales volumes, which showed grocery spending outpacing restaurant spending. The data indicated that checks at restaurants and hotels were 5 - 7 percent lower on average so far in 2017.

Discounted rates – latest weapon for the hospitality industry

It has become clear that many restaurants and hotels have turned to discounting in an effort to fight the slowdown in consumer spending. Back in December 2015, food for consumption at home became five percent cheaper in the Kingdom, while restaurant and hotel rates fell around two percentage points. Lower prices can also be attributed to a stronger US dollar.

Impact of the new laws as yet unclear

The national policy of replacing expatriates with Saudi nationals in the private sector, known as Saudization, remains a burden for many businesses, especially those looking for low-skilled labor. Around 70 percent of workers in the Kingdom are foreigners. Moreover, expats make up between 80 and 90 percent of the low-skilled labor workforce.

A levy of SR 200 per month is paid by companies operating in the Kingdom on each expat employee they hire over and above the number of local workers. An expat levy to be phased in by 2020 will increase labor costs, especially those of hotels and restaurants, by pushing charges to up to SR 800 per worker.

The food and beverage industry will also be directly affected by the 50 percent tax on soft drinks, which aims to curb obesity levels in the country, and the 100 percent tax on cigarettes and energy drinks.

Optimism for tourism

A recent hike in development related to tourism has also been evident of late. A total of 170 hotel masterplans have been finalized and transferred to the execution phase in the KSA, 48 of them in Riyadh alone, highlighting the potential for a further surge in the country's tourism sector. Currently, F&B spending per visitor comprises about 14 percent of the spend in Dubai and 32 percent of that in Abu Dhabi.

Consensus

The vision of the Kingdom's leadership, the royal family, is to aim high, think big and make bold moves. Given current macroeconomic conditions, it won't be plain sailing, as a diagnosis and analysis of the challenges and opportunities within the KSA's hospitality sector for the months ahead indicate. However, overall, growth rates look likely to accelerate in 2018. The IMF expects the Kingdom's growth to rebound to 2.3 percent y-o-y, slightly less than the lender's October forecast of 2.6 percent, but still heading in the right direction.

PROTOCOL Hospitality Management & Consultancy *protocollb.com*

VAT rates comparison in a few markets