

VAT GUIDELINE FOR GOVERN- MENT BODIES IN KSA

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VERSION 1.0



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1. Introduction

Zakat and Tax and Customs Authority (“ZATCA”)

ZATCA is the authority tasked with regulating, enforcing, administering, and implementing taxation in the Kingdom of Saudi Arabia (“KSA”). ZATCA is responsible for the administration and collection of all taxes, including Value Added Tax (“VAT” or “Tax”).

The role of ZATCA includes raising VAT awareness among taxpayers, providing information for Taxable Persons to understand their VAT obligations, and facilitating VAT compliance. As part of this, ZATCA has released many guidelines to provide additional clarification on VAT, in relation to specific sectors and circumstances.

VAT in KSA

VAT is an indirect tax levied on the import and supply of goods and services at each stage of production and distribution. VAT was introduced in KSA with effect from 1 January 2018 at a standard rate of 5 % on all supplies and importations, including sales made as part of an Economic Activity. Limited exceptions to VAT were also introduced: such as the lease of residential property and certain financial services which are VAT exempt.

With effect from 1 July 2020, the standard rate of VAT was increased to 15% on Taxable Supplies.

This Guideline

This guideline is directed towards Saudi Government bodies, with the objective to provide clarifications with respect to the interpretation of Economic Activity for VAT purposes, in addition to the VAT treatment of transactions between persons and such bodies.

The guideline provides information on the VAT treatment of activities undertaken by these bodies, especially those activities that are subject to VAT, and those that are outside the scope of VAT.

This guideline solely serves as guidance material and does not include or purport to include all relevant information or legal provisions in relation to Taxable Person's activities. It is not binding on ZATCA or on any Taxable Person in respect of any transaction carried out and it cannot be relied upon in any way.

However, for further advice on specific transactions you may apply for a ruling, or visit the official website at (zatca.gov.sa) , which contains a wide range of tools and information that has been established as a reference to support persons subjected to VAT, as well as visual guidance materials, all relevant information, and FAQs.

2. Definitions of the Main Terms Used

The Economic Activity

“An activity that is conducted in an ongoing and regular manner including commercial, industrial, agricultural or professional activities or Services or any use of material or immaterial property and any other similar activity.”¹

Government Bodies

This term is not defined for VAT purposes, but this is intended to be interpreted broadly to include all forms of state and local government. This includes:

1. The statewide authorities (executive, judicial and legislative authorities, and government departments or ministries);
2. Regional and local government authorities, including municipalities; and
3. Other bodies governed by public law, which form part of the public administration or carry out the duties empowered and designated by the state.

This includes government bodies of all types.

Government bodies are generally funded by the state for wider public good, or are established to carry on a regulatory activity.

¹ Article 1, Definitions, Unified VAT Agreement

Person

“Any natural or legal person, public or private, or any other form of partnership.”²

Taxable Person

“...a Taxable Person in the Kingdom is a Person who conducts an Economic Activity independently for generating income, and is registered for VAT in the Kingdom or who is required to register for VAT in the Kingdom under the Law or these Regulations.”³

Taxable Supplies

“Supplies on which Tax is charged in accordance with the provisions of the [Unified VAT] Agreement, whether at the standard rate or zero-rate, and for which associated Input Tax is deducted in accordance with the provisions of the [Unified VAT] Agreement”⁴

Exempt Supplies

“Supplies on which no Tax is imposed, and from which associated Input Tax is not deducted pursuant to the provisions of the Agreement and Local Law.”⁵

² Article 1, Definitions, Unified VAT Agreement

³ Article 2, Taxable Persons required or eligible to register in the Kingdom, VAT Implementing Regulations

⁴ Article 1, Definitions, Unified VAT Agreement

⁵ Article 1, Definitions, Unified VAT Agreement

Customer

“A Person who receives Goods or Services.”⁶

Supplier

“A Person who supplies Goods or Services.”⁷

Tax due date

Tax becomes due on the date of the supply of Goods or Services, the date of issuance of the tax invoice or upon partial or full receipt of the Consideration, whichever comes first, and to the extent of the received. This date may differ from the date the goods or services are actually provided.

Supply

“Any form of supply of Goods or Services for consideration in accordance with the cases provided for in Chapter Two of [the Unified VAT] Agreement.”⁸

Deemed (Nominal) Supply

“Anything that is considered a supply in accordance with the cases provided for in Article 8 of [the Unified VAT] Agreement.”⁹

⁶ Article 1, Definitions, Unified VAT Agreement

⁷ Article 1, Definitions, Unified VAT Agreement

⁸ Article 1, Definitions, Unified VAT Agreement

⁹ Article 1, Definitions, Unified VAT Agreement

Input tax

“Tax borne by a Taxable Person in relation to Goods or Services supplied to him or imported for the purpose of carrying on the Economic Activity.”¹⁰

¹⁰ Article 1, Definitions, Unified VAT Agreement

3. The Economic Activity and Registration for VAT purposes

3.1. What is an Economic Activity?

The definition of an Economic Activity for VAT purposes is twofold. Firstly, that the activity is conducted in an ongoing and regular manner; secondly that the Economic Activity contains known Economic Activities and similar activities.

3.1.1. An Activity being conducted in an Ongoing and Regular Manner

Continuity and regularity of a person in making and receiving supplies is one of the key elements for the carrying on of an Economic Activity. Other activities carried on by a person other than the making of supplies may be regarded as an indicator of the carrying on of an Economic Activity in an ongoing and regular manner (such as preparatory activities).

Generally, the concept of 'ongoing and regular' will depend on the nature of the business or activity carried out by the person, in addition to other factors. The evaluation of whether a person carries on an economic activity will be made with regard to the acts that the person undertakes relating to the making of supplies. These factors are indicative and not exhaustive, in determining whether a person is carrying out an economic activity in an ongoing and regular manner, or whether he seeks to carry out an economic activity in that way.

Example: A restaurant in Jeddah temporarily closes in April 2020 due to restrictions imposed by the COVID-19 pandemic. After the end of the lockdown, the owner arranges for a new kitchen to be installed and hires a new head chef. The restaurant opens in November 2020 with new décor and a new menu. Despite the gap in trading, the owner has carried on an Economic Activity during the whole period of 2020.

The date of commencement of the Economic Activity is the date on which the person does the act or takes a step that makes it clear that the person has done so for the purpose of commencing or carrying on the economic activity in an ongoing and regular manner.

Example: A person establishes a plastic packaging factory in Al Jubail Industrial City in 2019, and he imports machinery and equipment to be used in production in the same year, with the actual production to begin in the year 2021. The factory will not make any supplies before 2021, but despite that, the person will be regarded as carrying on an economic activity throughout the period 2019 to 2021.

3.1.2. An Economic Activity includes known Economic Activities, and activities similar thereto

An Economic Activity as defined in the Unified VAT Agreement, and in KSA VAT Law, is a broad but not exhaustive list, including:

- Commercial activities or services
- Industrial activities or services
- Agricultural activities or services
- Professional activities or services
- Use of material or immaterial property
- Any other similar activities.

Generally, all commercial activities are presumed to fall within the scope of Economic Activity. Conversely, the Economic Activity is not intended to include activities carried out by a Government Body in its capacity as a public authority. Specific rules apply in examining whether Government bodies carry on an Economic Activity for VAT purposes.

The Implementing Regulations state that: “Any activity exercised by a Government Body in its capacity as a public authority shall not be considered to be an Economic Activity for the purposes of the Law and these Regulations.”¹¹

¹¹ Article 9, Registration provisions applying to specific circumstances, VAT Implementing Regulations

Where these bodies carry out the designated activities assigned to them by the State through the Law, Royal Decree or order establishing those bodies to carry out public functions, this does not constitute an Economic Activity and falls outside out of the scope of VAT. This is regardless of whether it makes charges or accepts charges for carrying out these functions.

This means that Government Bodies that do not carry on activities other than in their capacity as a public authority will not be required to register for VAT, or to charge VAT on those non-economic activities.

Example: A Royal Decree was issued in June 2020 stating that a specific Government Ministry shall be responsible for issuing special permissions for businesses to provide cloud services in KSA. The Ministry will charge the businesses a fee of SAR 5,000 to issue the permission which will be valid for 3 years. Although such a supply made by the Ministry will be made in an on-going and regular manner, it will be excluded from the scope of VAT as it does not constitute an Economic Activity by the Ministry, as it is the sole provider of such a supply by law.

Example: A local Government authority in Riyadh has a free space inside its premises. The Authority leased such space to a local coffee supplier in order to serve the employees of the Authority during the working hours only. The Authority charges a minimal amount on monthly basis. This activity is not one of the functions designated to the local authority by the state. This activity is therefore an Economic Activity.

3.2. Economic Activity and Requirement for Registration

To determine whether a Government Body is required (or eligible) to register for VAT, such body must first establish whether it carries on an Economic Activity¹² as outlined in the above sub-section.

An Economic Activity may be carried out equally by other Persons (natural persons - individuals or legal persons). It will be presumed by ZATCA that a person that regularly makes supplies of goods or services carries on an Economic Activity. Government Bodies who carry on an Economic Activity must register for the purposes of VAT if so required, and such bodies must collect the VAT applicable to their taxable activities, and pay the tax collected to the Authority. More information on registration for VAT is contained at zatca.gov.sa

¹² Article 3, Registration for Tax Purposes, VAT Law

All persons who carry on an Economic Activity and register for VAT purposes will receive a Tax Identification Number from ZATCA¹³.

3.2.1. Mandatory Registration

Registration is mandatory for all persons whose annual turnover exceeds the “mandatory VAT registration threshold”. If the total of a person’s Taxable Supplies made during 12 months exceeds SAR 375,000 that person must register for VAT¹⁴.

For the purposes of calculating registration threshold, taxable supplies do not include:

- Exempt supplies: such as exempt financial services or residential rental which qualifies for VAT exemption.
- Supplies taking place outside the scope of VAT in any GCC state
- Revenues on sales of capital assets - a capital asset is defined as an asset allocated for long-term business use.

More information on mandatory registration for VAT is contained at zatca.gov.sa

¹³ In accordance with Article 53, Tax Identification Number (TIN), Unified VAT Agreement

¹⁴ Article 50, Mandatory Registration, Unified VAT Agreement

3.2.2. Optional VAT Registration

It is possible for any person resident in the Kingdom of Saudi Arabia who has a taxable supplies or taxable expenses exceed SAR 187,500 (the “optional registration threshold”) within a period of 12 months to affect a voluntary registration for VAT¹⁵ .

More information on voluntary registration for VAT is contained at zatca.gov.sa

¹⁵ Article 7, Voluntary Registration, Implementing Regulations and Article 51, Voluntary Registration, Unified VAT Agreement

4. Government Bodies

4.1. Government Body Acting as a Public Authority

Where Government Bodies carry out the designated activities assigned to them by the State through the Law, Royal Decree or order establishing those bodies to carry out public functions, this does not constitute an Economic Activity and falls outside out of VAT scope.

This is regardless of whether it makes charges or accepts charges for carrying out these functions; even if the Government Body is VAT registered.

Example: A Saudi government authority has the issuing of operational licenses to businesses in a certain sector as one of its core functions. The authority charges a fee of SAR 1,500 to the business for the license and an administrative fee of SAR 750 for renewal of the operational license. The government authority does not carry out an Economic Activity in respect of the issue and renewal of these licenses. VAT is not included on the fees charged to companies in consideration of the issue and renewal of such licenses.

It should be noted that governmental activities, supplies or services are not regarded as being outside the scope of VAT unless they are directly provided by the Government Body empowered to do so.

In certain cases, a Government Body may subcontract to a commercial business (whether private or owned by the State) to carry out certain parts of its functions. Please refer to section 7 of this guideline for more details.

4.2. Government Body not acting as a Public Authority

4.2.1 Government Owned Companies

In certain cases, a Government Body will have the right to acquire shares in companies, such as Joint Stock Companies (JSCs) or Limited Liability Companies (LLCs) operating in KSA. These companies are not public bodies – even where a majority of ownership is by Government - and do not act in a public authority capacity. Therefore, such companies will be viewed to be carrying on an Economic Activity similar to privately owned companies and will be subject to normal VAT rules in KSA.

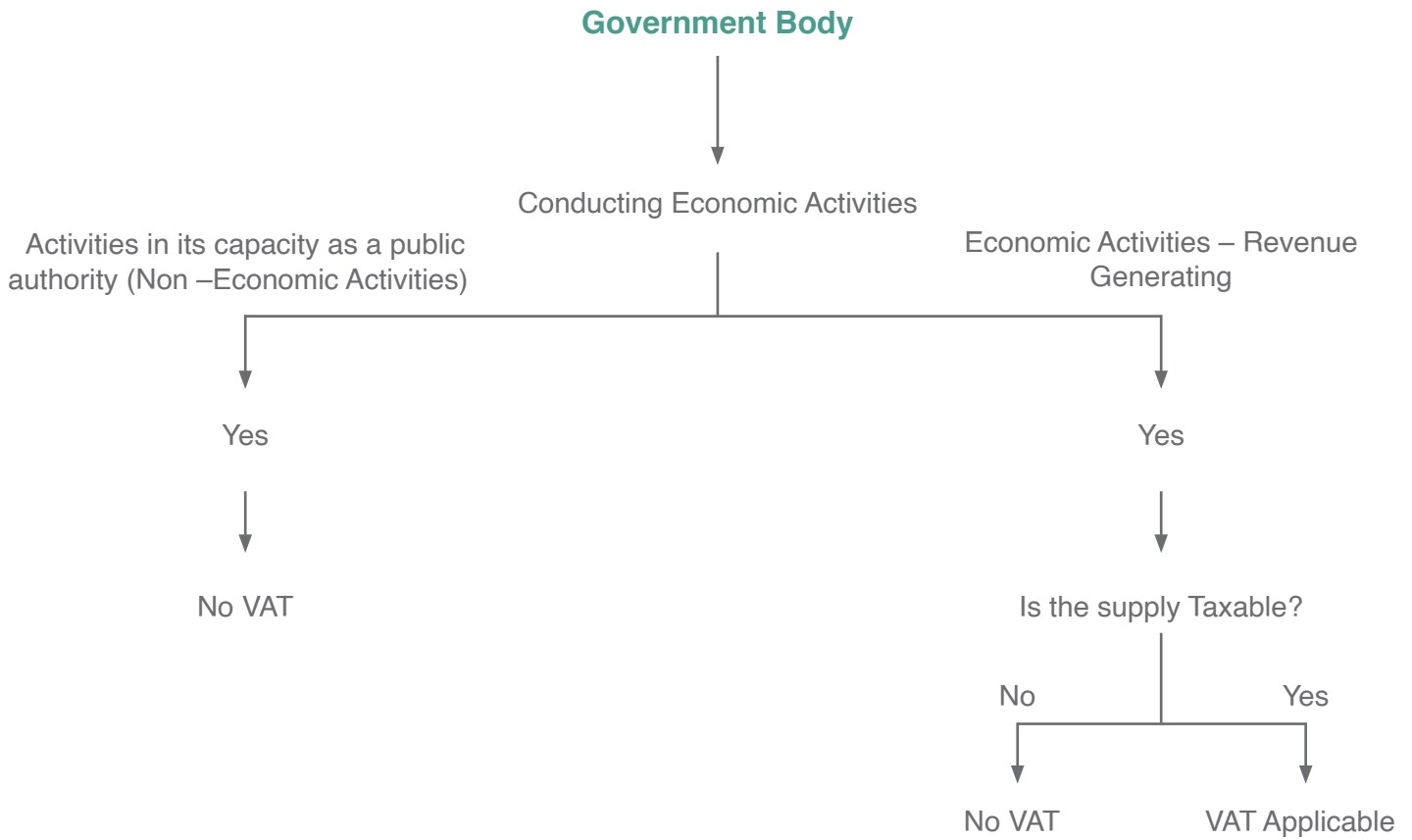
4.2.2. Commercial Activities

In some cases, a Government Body may have other activities in addition to its designated functions empowered by the state. Any Economic Activities of a Government Body may be viewed as an Economic Activity because it is not considered as being carried on by a Government Body in its capacity as a public authority. Therefore, such a body must follow the VAT registration rules and provisions, and in the event the Government Body is required to register for VAT

(and therefore a Taxable Person) VAT should be charged on all taxable supplies made as part of its Economic Activity.

Example: A local municipal authority in the Eastern Province has a budget surplus and has additional funds available in its bank account. To best manage and protect these excess funds until they are required for public use, it appoints an investment manager to invest in buying and renting commercial real estates. The investment activity is not one of the functions designated to the local authority by the state. The investment activity is an Economic /Commercial activity.

Flowchart (1): Summary



5. Supplies Received by Government Bodies

5.1. Payment of VAT by Government Bodies

A Taxable Person must account for VAT on its taxable supplies of goods or services regardless of the customer identity (individuals, companies, Foreign Governments, International Organizations, Diplomatic and Consular Bodies and Missions, or Government/public bodies). As such, taxable supplies of goods or services made to Government Bodies in KSA will be subject to VAT in accordance with normal rules.

Government Bodies are therefore required to pay VAT on the taxable supplies they receive in KSA. This is regardless of whether the supplies purchased by a Government Body relate to Economic or Non-Economic Activities.

Example: The Golden Line Technology Company, a company established in KSA and registered for VAT, has entered into a contract with the Ministry of Housing to provide technical support for the internal IT system at the Ministry for a period of 8 months starting Dec. 2020 with a total amount of SAR 180,000. Such a contract includes a taxable supply made by the Golden Line Company to the Ministry and must be subject to VAT at 15%.

Furthermore, when a Government Body receives supplies of goods or services in KSA under the place of supply rules from a non-resident supplier (not including imports of goods), there are two scenarios:

If the Government Body is not registered for VAT Or the supply was only related to public authority's activities, the non-resident supplier will be liable to account for VAT in KSA and accordingly obligated to register for VAT. More details regarding VAT registration for non-residents are available at the General VAT guideline and ZATCA website.

If the Government Body is VAT registered and the supply relates to its Economic Activity, the Government Body is deemed to make a supply to itself ¹⁶ , with VAT due under the Reverse Charge Mechanism. More details are included in sub-section 6.4 in this guideline.

Ministry of Finance has published its circular No. (71664) dated 51439/7/H to all Government Bodies and public authorities confirming that all such bodies and must pay VAT on taxable purchases that took place on or after January 1, 2018, for all contracts.

A Taxable supplier who is making taxable supplies to Government Bodies is obligated to follow the general VAT rules and issue tax invoices towards its supplies and manage all related responsibilities and obligations.

¹⁶ Article 9, Receiving Goods and Services, Unified VAT Agreement

5.2. Imports by Government Bodies

Generally, VAT is chargeable on the import of goods into KSA.¹⁷

A Government Body may import goods, and VAT due on such imports will be charged by authority and needs to be paid at the point of entry into KSA. If the Government Body is the named importer, who is licensed to import the goods and is shown as the importer on the customs declaration, then it will be liable to pay import VAT.

VAT needs to be paid at the point of entry before those imported goods enter free circulation in KSA, unless the registered importer for VAT purposes, successfully applies for authorization for the payment of VAT on imports to be made through the VAT Return, instead of being collected by the authority on importation.¹⁸

Generally, the right to the deduction of import VAT sits with the importer taking into consideration the conditions of tax deduction. Please refer to section 6 of this guideline for details regarding Input Tax deduction.

Imports of certain goods, or imports made in certain cases, are exempt from import VAT. These include:

- Goods whose supply are exempt for VAT purposes;

¹⁷ Article 2, Scope of Tax, Unified VAT Agreement

¹⁸ Article 44, Payment of Tax on imports through the Tax Return, Implementing Regulations

- Goods which are exempt from the authority under specific exemptions in the Common Customs Law, being:
 1. diplomatic exemptions;
 2. military exemptions;
 3. imports of used personal luggage and household appliances which are brought by citizens residing abroad and foreigners who are coming to reside in the country for the first time;
 4. Imports of returned Goods.¹⁹

5.3. Supplies between Local Government Authorities/Bodies

Supplies between local authorities including transferring activities between Government Bodies – in whole or partially are not regarded as Economic Activities provided that they are made by the Government Body in its capacity as a public authority. Otherwise, such supplies fall within the scope of VAT and VAT must be accounted for at the appropriate rate.

Example: A Government Ministry in KSA is providing data storage services to other ministries and authorities in KSA, being officially the responsible Government body to do so. In this regard, the Ministry charges other ministries and authorities with an annual fee of 50,000 SAR.

¹⁹ Article 38(2), Exemptions on Import, Unified VAT Agreement and Article 42, Exemptions for imports, Implementing Regulations

Such charges will be considered as out of VAT scope as such activities made in its capacity as a public authority. Conversely, the Ministry is also eligible to provide same storage services to private businesses in KSA with annual charges of 150,000 SAR. This supply is considered as a Taxable supply made by the Ministry and part of an Economic Activity. The Ministry must check the VAT obligations related to these supplies i.e. registration requirements and charging VAT.

5.4. Transitional Provisions of VAT Rate Increase to 15% - Relief for Existing Contracts with Government Bodies

VAT has applied in Saudi Arabia since 2018 at a standard rate of 5 % on all supplies and importations, with limited exceptions (such as zero rated supplies and exempt services). On 11 May 2020, the Ministry of Finance announced a change to the domestic VAT laws would take place to increase the standard rate of VAT to 15% (“the revised rate”) with effect from 1 July 2020, as part of a range of necessary measures undertaken to protect the Saudi economy and overcome the unprecedented financial and economic ramifications of the global coronavirus pandemic in the best way possible. Accordingly, a special rule applies in cases where a Taxable Supplier has supplied goods or services under a signed contract with a Government Body in KSA before 11 May 2020²⁰. The term “Government Body” is defined in section 2 of

²⁰ Article 79, Transitional provisions, Implementing Regulations

this guideline. Contracts with Government Bodies are often awarded through a unified online Government procurement portal (Etimad), and are typically awarded for a gross contract amount which includes VAT. The transitional provisions related to the application of the revised Tax rate include a relief from applying the revised rate where the Taxable Supplies relate to a contract which has been concluded with a Government Body before **11 May 2020**. The Supplier may apply the 5% rate of VAT on such supplies up to the earlier of the end of the contract, renewal of the contract, or 30 June 2021²¹ .

Example: On 15 January 2020, a company signed a contract with a Government Body to supply computers with a value of SAR 500,000 plus 5% VAT of SAR 25,000, the computers will be supplied in a phased manner, and the last phase will be ended August 2020. The VAT rate applicable to that supply is 5% as the contract is a B2G contract signed before 11 May 2020. This tax treatment may be beneficial for both Supplier and Government Body, as it is required to do a revision of the terms of the awarded contract.

A Government-owned company with separate legal status does not constitute a Government Body and it is not qualified to have the same special tax treatment for government bodies. However, transitional provisions on contracts between Taxable Persons might still be applicable on contracts with a Government-owned company.

²¹ Article 79, Transitional provisions, Implementing Regulations

6. Claiming Input Tax on Purchases – Input Tax Deduction, Apportionment and the Reverse Charge Mechanism

6.1. Right to deduct Input Tax

A Government Body will only be able to deduct input tax incurred on its purchases of goods and services if such a body is using these purchases for the purpose of carrying on an Economic Activity and in the course of making Taxable Supplies.

Therefore, a Government Body is required to determine when they are making supplies beyond those that they have a statutory requirement to make in their capacity as a public authority.

Generally, a Taxable Person may deduct Input Tax incurred on goods and services it purchases, receives or imports in the course of making Taxable Supplies. The Deductible Tax is entered on the VAT return and is offset against the VAT charged on supplies (output VAT) made during that period.

The incurred input tax may include the following:

- VAT on the inputs of a VAT registered person, charged by a VAT-registered supplier in KSA;
- VAT on the inputs of a VAT registered person self-accounted for by him under the Reverse Charge Mechanism;
- The VAT on imports to a VAT registered person paid to the authority on imports of goods into the Kingdom. Please refer to sub-section 5.2 above.

A Taxable Person may deduct Input Tax charged on Goods and services supplied to that Taxable Person, to the extent these are received in the course of carrying on an Economic Activity and constitute of ²² :

- a. Taxable Supplies including zero-rated Supplies;
- b. Internal Supplies;
- c. Supplies that would have been Taxable Supplies had they been made in the Kingdom.

The terms “for the purpose of carrying on the economic activity” and “in the course of making Taxable Supplies” mean that deduction requires supplies purchased to have a sufficient link between these supplies and the onwards supplies of the Taxable Person. However, it is not necessary that goods have a direct link to a specific onwards Taxable Supply to qualify for deduction.

As a general rule, input VAT relating to Non-Economic activities may not be deducted. In addition, input VAT may not be deducted on some blocked expenditure types which supposed to be received outside the scope of the economic activity. such as entertainment and restricted motor vehicles²³, or on any costs which relate to making exempt supplies.

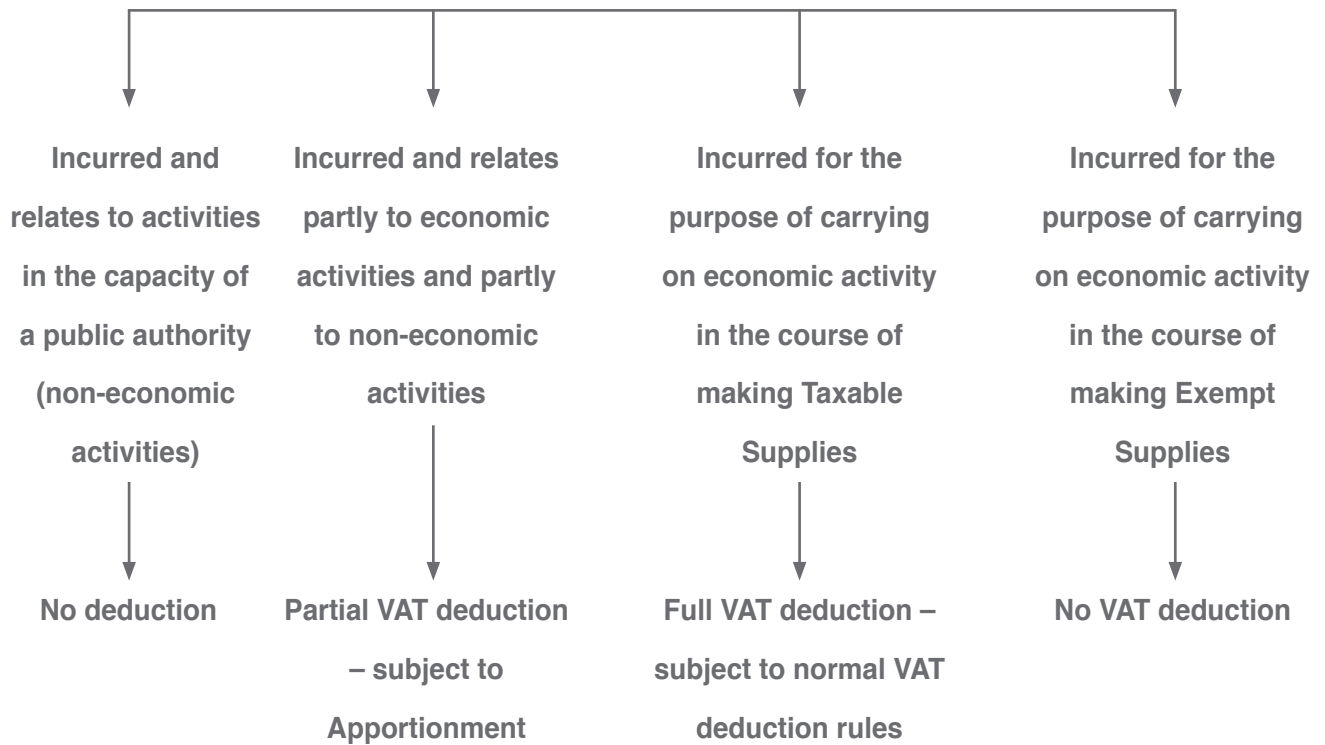
Input VAT which relates partly to taxable and exempt activities must be apportioned for deduction purposes.

²² Article 49, Input Tax deduction, Implementing Regulations

²³ Article 50, goods and services which supposed to be received outside the scope of the economic activity, Implementing Regulations

Flowchart (2): When a Government Body can deduct input tax

VAT incurred on Purchases – Input Tax



6.2. Input Tax Deduction Requirements

For Government Bodies to deduct input tax incurred in KSA, there are a number of requirements to be followed:

1. The VAT incurred by the Government Body must relate to a taxable activity: If the VAT relates directly to the Government Body's Non-Economic Activity then the VAT cannot be reclaimed.

2. VAT must be correctly charged: only VAT which is correctly charged on a supply of goods or services in KSA, by a VAT-registered supplier, is considered to be Input Tax for the Government Body as the recipient of that supply. VAT which is not correctly charged to a Government Body is not eligible for an Input Tax deduction. An amount which is not KSA VAT, but a corresponding VAT charged in another country, is also not eligible for Input Tax Deduction in KSA.

3. Verifying TIN and tax invoice: The Unified VAT Agreement requires that a Person must hold documents as a condition of Input Tax deduction. A Government Body should hold a valid Tax Invoice in order to deduct KSA VAT charged by suppliers as Input Tax²⁴. The Government Body should also verify the TIN number of the supplier using the VAT Lookup function made available by ZATCA, to ensure that a VAT-registered supplier has charged the VAT. Suppliers or service providers contracting with the Government bodies should ensure that the tax invoices are issued showing accurately and correctly the name of the correct body as recipient (customer).

In case the VAT supply is self-accounted through the Reverse Charge Mechanism by the Government Body, a valid Tax Invoice will in these cases not be issued by the supplier. In order to be eligible for the deduction of Input Tax on such a supply,

²⁴ Article 53(5), Tax Invoices, Implementing Regulations

the Government Body should have commercial documents available to evidence the nature of the supply and the consideration payable on the supply, in addition to the corresponding calculation of tax due on the supply.

6.3. Eligibility to Deduct Input Tax

As mentioned above, the right of the Government Body to deduct is based on the goods and services being purchased for the purpose of carrying on its Economic Activity in the course of making Taxable Supplies. Conversely, VAT incurred on purchases made outside of a Government Body's Economic Activities, or Input Tax which is related to VAT exempted activities is not deductible as Input Tax.

6.3.1. Apportionment between Economic and Non-Economic Activities

If a Government Body carries on both Economic Activity and non-Economic Activity, the Input VAT deduction should be determined based on whether the supply made by the Government Body being a taxable person is in the course of carrying on its Economic Activity as follows:

- Input VAT attributed to the supplies made to the taxable person in the course of the carrying on by him of his Economic Activity shall be deductible in full;
- Input VAT attributed to the supplies made to the taxable person in the course of the carrying on of a non-economic activity shall not be deductible;
- Other input VAT that cannot be directly attributed to Economic or non-Economic Activities shall be subject to partial deduction based on apportionment, as set out below:

The VAT law does not set out a specified method or mechanism for the calculation of the apportionment between Economic Activities and non-Economic Activity (as it does for taxable and exempt activities).

Government Bodies must use a method that clearly and fairly reflects how the taxable supplies paid by the Government Bodies have been used; and the extent to which they have been used in Economic Activities. The method should be based on verifiable data, which can be reviewed by ZATCA.

The Government Body must specify the amount of VAT incurred on supplies in the course of carrying out an Economic Activity, and the amount of VAT incurred relating to the Non-Economic Activity, before apportioning input VAT between taxable activities and exempt activities.

Example: A municipal authority carries on its activity in a public capacity as required of it by the Ministry of Municipal and Rural Affairs. It also owns properties which it rents for residential and commercial usage. Input VAT deduction is therefore only available to the extent costs relate to an Economic Activity.

On August 2020, the supplies made and received in relation to each activity are as follows – assuming no transitional provisions applicable:

Description	Supplies made (SAR)	Taxable Supplies received (SAR)	Input tax deduction eligibility
Public activities	0 – funded by state	4,800,000 (VAT = 720,000)	No Input VAT deduction – not incurred in Economic Activity
Taxable commercial rental	200,000 (output tax 30,000)	50,000 (VAT = 7,500)	Input tax deduction for 7,500
Exempt residential rental	300,000 (No VAT – exempted)	150,000 (VAT = 22,500)	No Input VAT deduction because the supplies are exempt from VAT
Non-attributable overheads, relating to all activities, economic and non-economic	N/A	1,000,000 (VAT = 150,000)	Input tax deduction based on apportionment

The authority's major activities are the activities that it carries out in its capacity as a public authority – therefore non-attributable overheads relate to Non-Economic Activities, and partly to Economic Activities. The allocation between Economic activities and non-economic activities described above must be carried out first. The authority allocates this based on the supplies received, which reflects a fair and appropriate use of the overheads:

Taxable Supplies received for Economic Activities

Taxable Supplies received for Economic & non-Economic Activities

$$\frac{50.000 + 150.000}{(50.000 + 150.000) + 4.800.000} = 4\%$$

6.3.2. Apportionment between Taxable and Non-Taxable Activities

VAT incurred which relates to a Government Body's VAT exempt activities, is not deductible as Input VAT. A Government Body as a supplier making both taxable and exempt supplies can only deduct the Input VAT related to the taxable supplies. The Input VAT available to Government bodies who make both exempt and taxable supplies must be determined based on:

- Input VAT exclusively and directly related to the taxable supplies shall be deductible in full;
- Input VAT exclusively and directly related to the exempt sales shall not be deductible;
- Other input VAT that cannot be directly attributed shall be subject to partial deduction based on apportionment²⁵. It is important that Government bodies undertake an apportionment that is fair and reasonable so that the input VAT reclaimed accurately reflects their taxable activities.

²⁵ Article 51, Proportional deduction of Input Tax, Implementing Regulations

The overhead costs/expenses incurred by the Government Body for making both taxable and exempted supplies must be apportioned to most accurately reflect the use of those costs in the taxable portion of the Government Body's activities.

A prescribed default method for proportional deduction using the value of taxable supplies made during the year is as follows:

The value of Taxable Supplies made by the Taxable Person in the last calendar year

The total value of Taxable Supplies and Exempt Supplies made by the Taxable Person during the last calendar year

Details regarding the methods and using alternative methods are covered in the Input Tax Deduction guideline.

Example: in reference to the above mentioned example, it can be seen that the proportion of overheads that can be attributed to Economic Activities amounts to 4% of the total overheads (SAR 40,000), and the tax paid thereon is SAR 6,000. In order to calculate the deduction of input tax, the municipality must thereafter attribute that tax of SAR 6,000 to taxable supplies and exempt supplies, using the apportionment mechanism between the taxable supplies and the exempt supplies, as follows:

$$\frac{200.000}{200.000 + 300.000} = 40\%$$

The municipal authority is able to deduct Input VAT of SAR 2,400 relating to taxable supplies, this being 40% of the SAR 6,000 of VAT on overheads relating to all Economic Activity supplies.

In order to correctly reflect VAT deduction for businesses making taxable and exempt supplies (including Government bodies), an adjustment must be made in the second column of field 7 of the VAT return. This adjustment should be calculated as:

- The VAT-exclusive amount of purchases attributed to exempt or other non-deductible supplies, plus
- The VAT-exclusive amount of the exempt/non-deductible portion of overheads.

The amount of deductible VAT for that period is automatically calculated in the third column. Following the end of the completed calendar year, a review of the proportional deduction is made, where the Taxable person who calculate based on the previous year's values , or based on an estimate of the current year must compare the values used in the fraction during that year with the actual values of supplies made in that calendar year, in order to reflect the correct proportional deduction based on the actual supplies for the entire year.

Therefore any resulting adjustment from a difference in calculating proportional deduction. should also be made by adjusting (in the second column of field 7) in the next tax return ²⁶.

6.4. The Reverse Charge Mechanism

A Government Body undertaking Economic Activities will be required to apply the Reverse Charge Mechanism in certain scenarios.

²⁶ Article 51, Proportional deduction of Input Tax, Implementing Regulations

The Reverse Charge Mechanism is defined in the GCC Unified VAT Agreement as the mechanism by which the Taxable Customer is obligated to pay the Tax due on behalf of the Supplier, and is liable for all the obligations provided for in the Agreement and the Local Law ²⁷.

In general, the Reverse Charge Mechanism is only due on services received by the Taxable Customer from the Non-Resident Supplier which are taxable in nature.

Examples of services that fall within the scope of the Reverse Charge Mechanism application – a non-exhaustive list are:

- Legal and professional services;
- Membership/ subscription services;
- Advertising services.

Reverse Charge Mechanism is not applicable on the following:

- 1.** The receipt of exempt services (for example: financial services received from a non-resident supplier). Such supply is not a taxable supply;
- 2.** Where a non-resident supplier makes a supply of goods or services subject to VAT in KSA to non-taxable persons. In this case, the Supply is subject to normal VAT liability rules. The non-resident supplier will be required to register for VAT in KSA and charge VAT on supplies ²⁸ ;
- 3.** Services that are directly in connection with the five specific categories of services (Special Cases) outlined in the Unified VAT Agreement ²⁹ . These are exceptions to the basic rule of Place of Supply.

²⁷ Article 1, Definitions, Unified VAT Agreement

²⁸ Article 5, Mandatory registration of Non-Residents obligated to pay Tax in the Kingdom, Implementing Regulations

²⁹ Articles (17-21), Unified VAT Agreement

As stipulated in the unified VAT agreement: “If a Taxable Person residing in a GCC Member State receives Services from a person who is not resident in the GCC Territory, then that Person shall be deemed to have supplied these Services to himself, and the Supply shall be taxable according to the Reverse Charge Mechanism”³⁰. As stated in the Implementing Regulations³¹, the Reverse Charge Mechanism applies in cases where a Taxable Person receives, from a non-resident supplier, a supply of services which are supplied in KSA under applicable VAT place of supply rules. The receipt of taxable services by a Taxable Person – when those services are supplied in KSA (under the place of supply rules) – from a non-resident supplier are subject to VAT under the Reverse Charge Mechanism at the applicable rate.

Under the Reverse Charge Mechanism, the recipient is deemed to have made the supply of services to himself. Therefore, the recipient must report Output VAT, and is at the same time eligible to deduct corresponding Input VAT, provided the standard criteria for deduction are met.

Example: ABC Consulting firm, a KSA resident and registered company, engaged with a Dutch legal advisor to provide legal advice for the possible expansion of ABC Consulting in Netherlands. The Dutch legal advisor issued an invoice for the fee of 10,000 USD (Approx. 37,000 SAR) in December 2020. No KSA VAT is charged on the invoice issued by the Dutch advisor and will therefore not be an Invoice complying with the tax invoice requirements stipulated in KSA VAT legislation. ABC is obligated to account for VAT on services received from the Dutch advisor as per the reverse charge mechanism with amount of 5,550 SAR.

³⁰ Article 9, Receiving Goods and Services, Unified VAT Agreement

³¹ Article 47(1), Persons liable to pay Tax, Implementing Regulations

As the invoice issued by the non-resident advisor shows the date of supply and consideration payable, it can be used to evidence the calculation of the taxable amount in order to determine the VAT due on the supply.

Further details around reporting requirement for Reverse Charge Mechanism through VAT returns are available in the Reverse Charge Mechanism circular published by ZATCA.

Where there is a supply being received in KSA from a non-resident supplier, there is often a link between the Reverse Charge Mechanism and Withholding Tax (“WHT”). WHT is an income tax assessed on non-residents who generate income from a source in the Kingdom. It requires the recipient of the supplies, namely the resident or permanent establishment in KSA who is making the payment to the non-resident, to withhold a part of that payment corresponding to tax and remit it to ZATCA. The WHT base is determined according to the total payment made, not the profit.

7. Agreements and Sub-Contracts between Government Bodies & Private Businesses

7.1. Sub-contracting Commercial Activities

In certain cases, a Government Body may subcontract to a commercial business (whether private or owned by the State) to carry out certain parts of its functions. In such cases, the subcontractor makes its supplies in the course of an Economic Activity, even where these are used in providing a public service.

Example: A Saudi government authority responsible of issuing trade licenses asks Al Saad Co to carry out checks on whether persons applying to obtain licenses from them are complying with health and safety regulations, as a requirement to satisfy the requirements for issue of the licenses for 100 persons. Al Saad Co impose a Consideration of SAR 120 (not including VAT) per check carried out on behalf of the government authority, but the government authority does not make any additional charges in respect of such check to persons applying for licenses. This consideration is charged as part of an Economic Activity and is subject to VAT. The VAT invoice issued by Al Saad Co will indicate the health and safety checks amount SAR 12,000 (100xSAR120) in addition to the VAT amount (SAR 1,800).

In other cases, a commercial business may collect a fee on behalf of a Government Body with whom it contracts. If the fee is collected in the name of the government authority, and forms part of the Government Body's designated public activities - this will not be subject to VAT despite being collected by a commercial business.

Example: An immigration consultant in KSA provides consultancy services to migrant workers resident in KSA to renew work visas. The consultant charges a fee for its services, and collects the designated charge from the customer to pass directly to MOFA for the visa application. The fees that are transferred to MOFA are not subject to VAT. An invoice to the customer will include:

1. Consultancy Services – subject to VAT
2. Visa Charges by MOFA – not subject to VAT

7.2. Government Bodies establishing companies

In certain cases, a Government Body may establish a fully (or partly) owned private company to undertake some of its activities. Essentially, these companies are created to undertake commercial activities on behalf of the Government, and such companies are funded by and report to Government.

These companies are not public bodies – even where the full ownership is by the Government - and do not act in a public authority capacity. Therefore, such companies will be viewed to be carrying on an Economic Activity similar to other privately owned companies and will be subject to normal VAT rules in KSA

Example: A public utility provider is established as a JSC, with %100 of shareholdings held by KSA Government. The company provides utilities to private and business customers in return for regular charges. The JSC carries on an Economic Activity for the purpose of generating income and will be required to register for VAT in the event that the relevant conditions are satisfied.

8. Tax Compliance Obligations

8.1. Charging VAT

Where Government Bodies are carrying out activities in their capacity as a public authority, these are not deemed to be Economic Activities and they are therefore outside the scope of VAT.

Where Government Bodies are carrying out Economic Activities, normal VAT rules will apply.

Generally, VAT is charged by the Taxable Person on almost all types of supply, with most being subject to the standard 15% rate. There are predominant categories of supplies in KSA where VAT is charged or not charged including the zero rate applicable on certain taxable supplies e.g. Export of goods and supply of qualifying medicines and qualifying medical goods.

Each tax invoice for a Taxable Supply must show the date the supply takes place (also referred to as the “date of supply” for VAT purposes). This is the date upon which the VAT for that supply “becomes due”, determined in accordance with The Unified VAT Agreement:

“Tax becomes due on the date of the supply of Goods or Services, the date of issuance of the tax invoice or upon partial or full receipt of the Consideration, whichever comes first, and to the extent of the received amount ³² .”

The date the supply takes place determines in which Tax Period **the** supply is reported. Whilst each supply has a separate date of tax becoming due, the payment of VAT by the Supplier to ZATCA is only required when the VAT return is filed (and the corresponding Net Tax for that entire tax period is due for payment).

³² Article 23, Date of Tax Due on Supplies of Goods and Services, Unified VAT Agreement

8.1.1. Actual date of supply and earlier dates of supply

The actual date of supply of the Goods or services is, in standard cases, the date of delivery of the Goods or performance of the services. However, specific date of supply rules are prescribed in the Unified VAT Agreement and Implementing Regulations ³³.

Tax due date may be earlier than the actual date of supply, in cases where a tax invoice is issued or payment is received before the actual date of supply.

■ If a Tax Invoice is issued before the actual date of supply:

The Supplier must comply with VAT obligations based on the date of issue of the Tax Invoice. VAT must be reported as Output Tax in the Tax Period in which the Tax Invoice is issued (even if payment has not been received or the actual supply has not taken place).

■ If an advance payment is made before the actual date of supply:

The supply is deemed to take place on the date of payment (in cases of part-payment, the tax become due based on the portion of consideration paid). The Supplier must issue a Tax Invoice within fifteen days from the end of the month in which the advance payment was made for the portion of the consideration received.

In the case of a continuous supply of goods or services - which involves the provision of goods or performance of services continuously across a defined period, such supply takes place on the earlier of the date a Tax Invoice is issued or payment is made in respect of those Goods or services, to the extent of the amount invoiced or paid. Examples of continuous supplies include the rental of equipment, the provision of electricity or water by a utilities company, or the ongoing membership of a gym.

³³ Article 20, Date of Supply in specific circumstances, Implementing Regulations

Note that different date of supply rules apply for continuous supplies of goods or services involving the payment of consideration by instalments. Unless an advance payment is received, the date of issue of the Tax Invoice for continuous supplies will be the date of supply. If an advance payment is received, the earlier date of supply should be shown on the Tax Invoice.

In the event that no payment is received - nor any invoice is issued - in respect of a continuous supply, the supply is deemed to take place on the date falling twelve months after:

- The date the supply commenced; or
- The date the last invoice was issued or payment received;

Whichever of those dates is later.

8.2. Issuing Invoices

Each Taxable Person must issue (or arrange for the issuance of) a “standard” Tax Invoice to another Taxable Person or a non-taxable legal Person³⁴ or to a sole proprietorship or any other entity established in the Kingdom in accordance of the applicable laws therein, in respect of any Taxable Supply of Goods or Services, or any payment made in respect of such a Supply before that Supply takes place.

Such tax invoice must be issued, by no later than fifteen days following the end of the month in which the supply is made.

Every taxable person must issue a simplified tax invoice in the event that the value of the supply is less than SAR 1,000. With regard to supplies made by taxable persons to non-taxable natural persons, the taxable supplier must issue a simplified tax invoice for the supplies.

In both cases, the invoice must be issued no later than 15 days after the end of the

³⁴ Article 53, Tax Invoices, Implementing Regulations

month in which the supply took place ³⁵ .

The tax invoice must clearly detail certain information such as the invoice date, supplier's tax identification number, taxable amount, tax rate applied, and the amount of VAT charged.

If different rates have been applied to the supplies, the value of each item must be specified separately, as well as the VAT applied to that item.

Tax invoices are not required for supplies made outside the scope of VAT in the Kingdom. Therefore, supplies made by a Government Body on the capacity of public authority being outside the VAT scope do not require issuing tax invoices by the Government Body. However, supplies made by a Government Body in course of making taxable supplies as part of Economic Activities will require that body to issue tax invoices.

Further information on the requirements for tax invoicing can be found in the VAT Invoices & Records guideline.

³⁵ Article 55, Issuance of the Tax Invoice, Unified VAT Agreement, and Article 53(9), Tax Invoices, Implementing Regulations

8.3. Filing VAT Returns

Each VAT registered person – including Government Body registered for VAT in KSA, or the person authorized to act on his behalf, must file a VAT return with ZATCA for each monthly or quarterly tax period.

The VAT return is considered the taxable person's self-assessment of tax due for that period. Monthly VAT periods are mandatory for taxpayers with an annual turnover exceeding SAR 40 million.

For all other VAT registered persons, the standard tax period is three months. The VAT return must be filed, and the corresponding payment of net tax due made, no later than the last day of the month following the end of the tax period to which the VAT return relates.

8.4. Keeping Records

All taxpayers - including Government Body registered for VAT in KSA - are required by law to keep appropriate VAT records relating to their calculation of VAT for audit purposes. This includes any documents used to determine the VAT payable on a transaction and in a VAT return ³⁶ .

³⁶ Article 59, Retention Period for Tax Invoices, Records and Accounting Documents, Unified VAT Agreement and Article 66, Records, Implementing Regulations

This will generally include:

- Tax invoices issued and received;
- Books and accounting documents;
- Contracts or agreements for large sales and purchases;
- Bank statements and other financial records;
- Import, export and shipment documents; and
- Other records relating to the calculation of VAT.

Records may be kept in physical copy or electronically where the conditions specified in Regulations are met to do so, but in all cases, records must be made available to ZATCA on request.

All records must be kept for at least the standard retention period of 6 years. The minimum period for the keeping of records is extended to 11 years in connection with invoices and records relating to movable capital assets, and 15 years in relation to invoices and records relating to immovable capital assets.

Further information on the requirements for keeping records can be found in the VAT Invoices & Records guideline.

8.5. Relationship with ZATCA

Government bodies are subject to audits from ZATCA, and should respond to queries and information requests from ZATCA in a timely manner.

Furthermore, ZATCA provides a special account manager for government bodies to enhance communications between the authority and the body, for example:

- Registering the government bodies according to the basic requests.

1. The name of the body.
2. The number of the establishment “700”.
3. Personal information for the responsible of the account (name of the person, ID number “for authentication”, phone number, E-mail).
 - Confirming that the taxpayer received the information of registration and a full explanation of the available services at the authority website and the commitments that the body must declare.
Increasing awareness and knowledge regarding new laws and regulations, and providing the required support for all inquiries.
 - Strengthening the relationship between the authority and the government bodies by providing workshops, field visits and ensuring that the Government Body has effective communication with its account manager.
 - Raising the commitment level and emphasis on the taxpayers’ readiness to deliver their tax returns (VAT-withholding tax) and emphasis on paying the dues according to the legal periods.
 - Clarify checking requests and their purpose of it and working together to improve compliance.

Certificate of registration within the VAT system

A resident person – including Government bodies who is subject to VAT and registered with ZATCA in the VAT system must display a certificate to the effect that he has been registered in the VAT system in a place visible to the public at his main place of business and at all his branches ³⁷.

³⁷ Article 8(8), Application for registration, Implementing Regulations

Correcting past errors

If it becomes apparent to the taxpayer that there is an error or an incorrect amount in a filed VAT Return, or of any other VAT obligation which he has not complied with, he should notify ZATCA and correct the error by amending VAT the tax return. Errors resulting in a net understatement of VAT (above SAR 5,000) must be notified to ZATCA within twenty days of becoming aware of the error or incorrect amount, and he must amend the previous return ³⁸.

For small errors, resulting in an understatement of the net VAT of less than SAR 5,000, the taxable person may instead correct the error by adjusting the net tax in the following VAT return.

³⁸ Article 63, Correction of returns, Implementing Regulations

Contacting us

For more information about VAT treatments, kindly visit our website:



zatca.gov.sa

or contact us on the following number:



19993.

Q&A

Do I need to charge VAT on supplies I make to a Government body?

Even if a Government body does not carry on an Economic Activity, supplies to government bodies will still be subject to VAT, similar to supplies to a regular customer.

Will the Government body include VAT on its charges to businesses or individuals?

This depends on whether its charges are made in its capacity as a public authority or as an economic activity . If charges are made on supplies that are part of an Economic Activity by the Government body, then VAT must be charged.

Will the Government Body be obligated to register for VAT in all cases?

To determine whether a Government Body is required (or eligible) to register for VAT, such body must first establish whether it carries on an Economic Activity. Government Bodies who carry on an Economic Activity must register for the purposes of VAT if so required.

Q&A

A Government Body is carrying out its activities assigned to it by a Royal Decree, is VAT applicable on its charges?

No. Where Government Bodies carry out the designated activities assigned to them by the State through the Law, Royal Decree or order establishing those bodies to carry out public functions which implemented exclusively and not a competitive to the private sector , this does not constitute an Economic Activity and falls outside out of VAT scope.

I am a supplier of stationery supplies in Riyadh and registered for VAT. I have entered a contract with Ministry of Finance to provide stationery supplies for 6 months starting August 2021. do I need to charge VAT on such supplies?

Yes. A Taxable Person must account for VAT on its taxable supplies of goods or services regardless of the customer identity. As such, taxable supplies of goods or services made to Government Bodies in KSA will be subject to VAT in accordance with normal rules.

Q&A

Can the Government Body deduct input tax incurred on its purchases of goods and services e.g. local contract with a VAT registered supplier to provide new laptops and anti-virus program?

A Government Body will only be able to deduct input tax incurred on its purchases of goods and services if such a body is using these purchases exclusively for the purpose of carrying on an Economic Activity and in the course of making Taxable Supplies.

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