



The impact of VAT

on financial services in Qatar

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What does VAT mean for the Financial Services sector in Qatar?

It is anticipated that Qatar will announce Value Added Tax (VAT) law and its Executive Regulations during 2020.

All businesses in Qatar will be affected by the introduction of VAT. However, the implications are likely to be more complex for the Financial Services sector.

Most financial services are categorized as exempt supplies for VAT purposes, meaning that no VAT has to be charged to customers (output VAT). However there are exceptions, which will be covered further in this flyer. On the other hand, financial institutions are likely to pay VAT (input VAT) on goods and services they procure; e.g. for IT services, advisory services or building utilities.

In general, input VAT can be deducted if the goods or services that were procured are then used to deliver taxable supplies. However, VAT laws do not permit taxpayers to deduct input VAT if these expenses are related to the delivery of exempt supplies. As a consequence, input VAT could create a final burden for financial institutions.



How will VAT be applied to FS?

Most, but not all, activities within the financial services (FS) industry will qualify for VAT exemption. We have looked at how exemptions are applied to the industry elsewhere in the world, as it is likely that Qatar will follow similar principles.

General principle of VAT

Businesses can be required to pay VAT (input VAT) on the goods and services (known as supplies) they procure, and have to collect VAT from customers on supplies they deliver (output VAT) and pay to the government. In general, governments allow businesses to deduct the input VAT they pay (usually by offsetting it against the VAT that they collect).

Input VAT

VAT paid when procuring taxable goods or services

Output VAT

VAT charged on sales of goods and services

Net VAT payable

Net VAT payable = (output VAT - input VAT)

To date, countries around the world use different methods of taxation on financial services. The jurisdictions which most recently implemented VAT, financial services are often divided into two categories (or supplies) for VAT purposes – fee-based and margin-based. VAT is usually applied to services when an explicit fee, commission, discount or charge is involved, and is only applied to the separately identifiable charge. Examples of fee-based financial services include:

- investment advice
- money transfer fees
- bank account opening/closing/maintenance fees
- bank statement fees
- ATM transaction fees
- loan setup/renewal fees.

Margin-based supplies are often exempt from VAT and include:

- interest paid, or received, in respect of loans
- deposits
- guarantees
- life insurance and re-insurance products.

VAT on Islamic banking products

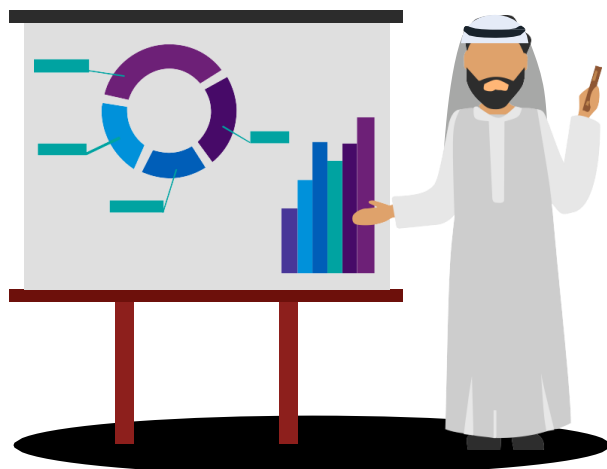
Sharia-compliant financial institutions provide banking services in compliance with Islamic law and VAT will be applicable on Islamic banking products as well.

VAT and Sharia compliance

VAT will most likely not be applied to margin profit earned by Islamic banks; however it could be applied to explicit fees paid to the bank. VAT treatment for each type of Islamic banking product; e.g. murabaha, musharaka, ijara, will have to be identified separately.

For example, when an ijara contract with a bank comes to an end, the ownership of the property passes to the individual. Therefore, the individual has a contractual relationship with the bank, not with the original seller of the property. Under this contract, the bank makes two supplies for VAT purposes:

- The supply of the underlying asset (the house) to the individual. VAT could potentially be chargeable on this supply.
- The supply of financing. The financing component of payments under the ijara will most likely be VAT exempt, as they represent the implicit profit margin derived by the bank on the ijara product.



How is input VAT recovered?

Since it is often not possible to clearly allocate expenditures to one particular activity, this brings complexity around how to calculate the input VAT deduction for 'mixed use' activities.

Input tax deduction

Financial institutions are likely to deliver taxable supplies (which allow input VAT deduction), as well as exempt supplies (which do not allow input VAT deduction). It is our understanding that Article 36 of the GCC framework suggests that member states should determine a recovery rate for input VAT incurred by financial institutions. However, as this is not explicit, the framework could permit different methods to be used. Around the world, a variety of methods are used to recover VAT; however the following two methods are the most frequently used within the financial services sector.

Singapore model

The Singapore model allows for a fixed VAT recovery percentage and seems, therefore, to be closest to the GCC framework agreement. This system has the advantage of being straight forward and can be easily managed by the tax payer. The fixed recovery rate (for example: 12 percent in commercial banking) is calculated using proxy statistics. It usually varies according to the type of banking license a financial institution holds and is reviewed annually.

Traditional model

The GCC member states that have already implemented VAT have decided to apply the traditional model of VAT recovery for financial services providers.

The traditional model ensures that:

- Input VAT charged on expenditure directly allocable to taxable activities can be deducted.
- Input VAT charged on expenditure directly allocable to exempt activities cannot be deducted.
- Input VAT charged on expenditure relating to taxable and exempt supplies (mixed use), can be deducted on a pro-rata basis, applied only to the taxable activity.

For most of the methods applied to deduct input VAT, businesses are forced to keep detailed records of procured goods and services to determine whether they were used for taxable or exempt supplies. Recently, some VAT jurisdictions have introduced specific methods for financial institutions to simplify this process.

Key considerations

There are a number of complexities which financial institutions face when applying VAT.

Determining taxable and exempt activities

Financial institutions are required to categorize supplies provided to their customers in taxable and exempt supplies. Even though VAT does not need to be withheld from exempt transactions, they have an impact on recoverable input VAT as highlighted above.

ERP system

Ideally, financial institutions will have an enterprise resource planning (ERP) system ready and suitably configured for the implementation of VAT. Vendor and customer master data may need to be changed, a tax condition logic will have to be established and tax codes will have to be created.

Regulations of the local central bank

Bank commissions are usually approved by a country's central bank and a threshold is identified for certain charges. With this in mind, applying VAT could decrease profit margins for financial institutions, which can have an impact on long-term revenues if banks do not take appropriate action.



How we can help

At KPMG in Qatar, we are committed to the end-to-end delivery of solutions which help your business manage the implementation of VAT in the most effective and efficient way possible. We have a Qatar-based team of highly-skilled professionals, with experience of delivering VAT services to some of the largest financial services clients around the world. Our team use KPMG's tried and tested methodology, drawing on global best practice to ensure that you get the results your business needs.

Consulting

KPMG's Indirect Tax and Management Consulting professionals based in Qatar, together with colleagues from our offices world-wide, are able to assist clients with requirements relating to the upcoming changes, including, but not limited to nexus – the VAT taxability impact assessment study, IT strategy, sourcing and procurement, contracting strategy, cost optimization, supply chain analysis, business strategy, business process re-engineering and reviewing compliance requirements.

Technology implementation

Our Transactions Tax Systems professionals, together with our Technology and Digital Advisory team, can assist clients that are implementing automated solutions with their transaction tax compliance processes, by providing a holistic technology view. This includes:

- reviewing, updating and testing IT system(s) and sub-modules
- ensuring proper and efficient interfacing between information systems.

Compliance

Our local Compliance Center can help clients to prepare and file new VAT returns.



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