MOORE STEPHENS

Impact review

Introduction of VAT for the GCC construction businesses

VAT

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"It can typically take 225 days for a company in the construction sector to collect the cash after completing the work and therefore cash flow can be a real issue."

With less than 12 months to go before businesses in the GCC are expected to start accounting for VAT, businesses should be well on the way to being ready. The introduction of VAT is more than just a finance issue, it is a business issue and could impact all areas of the business from purchase to pay, cash to report.

Whilst the actual legislation is yet to be published, and the specific details are still unknown, our industry experience indicates that construction businesses could be significantly impacted by VAT. The following are a number of common issues which you could expect to encounter.

Contractual arrangements

Construction projects can be years in the planning and subsequent delivery. Usually high-value, they can have a 'long tail' with final payments being delayed for long periods after the works have been physically completed. This is connected to how they typically involve many parties, including subcontractors, and the supply chains can be complex. These are just some of the reasons why VAT can be multifaceted for these projects and can result in VAT accounting errors.

The introduction of VAT could cause particular issues for projects which are already in progress as VAT may not have been contemplated from the outset of the project and contracts will probably be silent on VAT. It will be necessary to determine who will account for the VAT on supplies in these circumstances. If buildings have been constructed for businesses which are unable to recover the VAT charged, for example businesses in the financial services sector, VAT may be an absolute cost to the customer which may lead to funding issues or delays.

VAT should also be considered for tenders for future contracts as these will also be impacted by the introduction of VAT. The Gulf Council may introduce transitional rules to cover such contracts but they have not been announced yet. Therefore, businesses should proceed with caution.

VAT liability

The VAT liability of construction projects may be complicated, and there can be vast differences between commercial and domestic developments. There may also be different VAT liabilities for buildings used for multi-occupation and those built for non profit making organisations. Mixed use developments may have several VAT liabilities and an apportionment may be required.

No matter the type of project, the liability should be determined from the outset in order to avoid disputes in the future.

Billing arrangements

The nature of construction contracts can mean that the VAT invoicing arrangements can be complex and the tax points, the time when the tax is payable, can be difficult to determine. Typically a contractor may issue proforma invoices, requests for payment or authenticated receipts which do not create an immediate tax point. However, the receipt of cash will have to be monitored to ensure that VAT is accounted for, and indeed recovered, at the correct time.

Retentions

It can typically take 225 days for a company in the construction sector to collect the cash after completing the work and therefore cash flow can be a real issue. This will be exacerbated if the supplier is required to account for VAT on the supply before it receives payment from the customer.

One further complexity is that the consideration for a supply can be anything that is given in return for a supply which means that where there are reciprocal arrangements or barter transactions, VAT will need to be accounted for on both sides of such supplies.

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Supply chains

As VAT is a transaction-based tax, it applies to each stage of the supply chain. If materials are imported, VAT and duty may be payable on the imported goods. If overseas contractors are used, they may be required to register for VAT in the GCC or the recipient of the services may be required to account for notional VAT as a reverse charge. Whilst VAT should not be an absolute cost for most businesses involved within the construction industry, there could be cash flow issues.

However, it is worth noting that some countries operate a blocking order which means that VAT is not recoverable on specific items such as white goods and carpets etc.

Subcontractors

It is also common for the main contractor to self-bill subcontractors which means that they raise an invoice which is their evidence for input tax recovery and the subcontractors' output tax liability. Not all subcontractors will be registered for VAT and so care should be taken with this process.

Disputes

Finally, the nature of the construction industry is such that there are frequently disputes within the supply chain. As a result, the value of supplies can be subject to adjustment and damages and compensation payments can be made. Some payments will be subject to VAT whilst others will not be seen as supplies for VAT purposes.

Action

VAT can be a complex and expensive issue for businesses in the construction sector. In preparation for the introduction of VAT in the GCC we would strongly recommend that businesses:

- ☑ undertake a risk review to evaluate the potential impact of VAT;
- ☑ review existing contracts and determine the correct VAT position and who will pay for the VAT;
- ☑ review proposals and tenders to evaluate the impact of VAT;
- ☑ ensure all IT systems are VAT enabled, not just the accounting system;
- ☑ communicate with employees, customers, subcontractors and suppliers so that you can ensure that everyone is aware of potential issues and that there are no surprises come January 2018;
- ☑ implement training for employees who will be dealing with VAT and who need a broader understanding of its commercial implications.

VAT is a commercial issue not just a tax issue. We can assist you in ensuring that the impact on your businesses is managed.

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