VAT

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Tax Circular

VAT Treatment of Certain Supplies in the Financial Services Industry

The Zakat, Tax and Customs Authority ("ZATCA", "Authority") has issued this Tax Circular for the purpose of clarifying certain tax treatments concerning the implementation of the statutory provisions in force as of the Circular's issue date. The content of this Circular shall not be considered as an amendment to any of the provisions of the Laws and Regulations applicable in the Kingdom.

Furthermore, the Authority would like to highlight that the clarifications and indicative tax treatments prescribed in this Circular, where applicable, shall be implemented by the Authority in light of the relevant statutory texts. Where any clarification, interpretation or content provided in this Circular is modified - in relation to unchanged statutory text - the updated indicative tax treatment shall then be applicable prospectively, in respect of transactions made after the publication date of the updated version of the Circular on the Authority's website.

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1.Definitions

The following words and phrases, wherever they are contained in this Circular, mean the definition described in front of each of them, unless the context of the text states otherwise.

A. The Authority:

Zakat, Tax and Customs Authority.

B. Tax:

Value added tax.

C. Law:

Value Added Tax Law issued by Royal Decree No. M113 dated 1438/11/2H including any amendments that may follow it.

D. Implementing Regulations:

Value Added Tax Implementing Regulations issued by GAZT (formerly) Board of Directors Resolution No.3839 dated 1438/12/14 H including any amendments that may follow it.

E. Unified Agreement:

Common VAT Agreement of the States of the Gulf Cooperation Council (GCC) issued in November 2016.

F. Circular:

Tax Circular relating to the VAT treatment of certain supplies in the financial services industry.

G. Taxable person:

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

2. Subject matter of this Circular

2.1. This Circular provides information and guidance on the application of VAT rules in respect of two types of transactions involving banks and financial institutions in the Kingdom of Saudi Arabia (KSA):

- Supplies of services by international banks established in KSA to non-resident customers.
- Incentives provided by credit card companies to banks in return for achieving operational targets.

2.2. This Circular is based on the Unified VAT Agreement of the States of the Gulf Co-operation Council (Unified VAT Agreement), Value Added Tax Law (VAT Law), and Value Added Tax Implementing Regulations (Implementing Regulations) as well as the general practice with respect to applicable rules.

3.Situational Context

3.1. This Circular aims to provide guidance in respect of two transactional scenarios that may be of importance to banks and other licensed entities within the financial services sector.

3.2. Firstly, the Circular covers the VAT treatment of supplies of services by KSA-resident banks to non-resident customers. Depending on case specific circumstances, such services may either be taxable in KSA at the VAT rate of 15% or 0%, exempted from VAT or outside the scope of KSA VAT. This Circular provides the principles that should be considered by suppliers to determine the VAT treatment of a particular supply.

3.3. Secondly, this Circular covers the VAT treatment applied to incentive payments received by banks from credit card issuers. The VAT treatment will depend on the contractual and commercial arrangements between the parties and would typically constitute either a supply of services by the banks to credit card companies or a reduction of consideration for earlier supplies by the card issuers.

4.Supplies of services by KSA-resident banks to non-resident customers

4.1.Overview of main principles of imposition of VAT

4.1.1. Within the framework of its business activities, KSA-resident banks provide a range of services to their customers. Such services may include financial services as well as other types of services that do not fall under the term "financial services" as prescribed in Article 29 of the Implementing Regulations. Such non-financial services may include, for example, administrative services supplied by banks to their customers.

4.1.2. From a VAT perspective, the VAT treatment of supplies of services made by KSA-resident banks will depend on a number of factors including the place of supply of the services, the nature of the services, and the status and location of the recipient of the services.

4.1.3. The first step consists of determining whether a supply takes place in or outside the KSA. It must be noted that the supply of financial services occurs in the country where the supplier is resident. In other words, if the bank has a fixed branch in the KSA, the bank will be considered resident for VAT purposes even if it is incorporated or headquartered in another country.

4.1.4. Supplies of financial services provided by the branch in KSA is considered to take place in KSA for VAT purposes.

4.1.5. Having identified that the place of supply is in KSA, the supplier must determine the VAT treatment of the supply. In the financial services industry, the VAT treatment depends on the nature of the supply. Please refer to the table below for further details.

Type of Service	VAT Treatment
Financial services where consideration payable in respect of the service is by way of an explicit fee, commission or commercial discount.[1]	**15%**
Financial services where consideration payable in respect of the services by way of an implicit margin or spread. [2]	**Exempt**
Supplies of services to a non-resident customer, provided that none of the exclusions from zero-rating to non-residents apply	**0%**
Other supplies of services (unless zero-rated or exempt as displayed above)	**15%**

4.1.6. Supplies of services to non-resident customers are considered exported services and provided that the conditions for zero-rating prescribed in Article 33 of the VAT Implementing Regulations are met, the supply of exported services can be subject to the zero-rate.

4.1.7. The following sections of this Circular discuss the application of the zero-rating rules on supplies made by banks to their non-resident customers.

1. Article 29 (1) of the Implementing Regulations
2. Article 29(5) of the Implementing Regulations

4.2. The concept of "GCC member states"

4.2.1. Article 33 (1) of the Implementing Regulations states that a supply of services is zero-rated where it is made by a taxable person to a customer without a place of residence in any GCC member state.

4.2.2. This definition explicitly refers to "GCC member states" and/or "member states" when addressing the residency and location of customers. References to "GCC member state" in these rules cover GCC states that have introduced VAT and have an Electronic Services System in place with KSA. Until the GCC member states satisfy the above conditions, they will be considered as another country for the purposes of applying the zero-rating provisions. Nevertheless, this Circular refers to the term "GCC member states/member states/member state" to be consistent with the wording of the legislation.

4.3. Conditions to applying the zero-rate

4.3.1. As a general principle, the supply of services to a non-resident customer is zero-rated.

4.3.2. The zero-rate does not apply to a supply of services where any of the following exceptions apply: [3]

a. If the place of supply of the services is in any GCC member state pursuant to the special cases listed in Articles 17-21 of the Unified VAT Agreement. This does not include services supplied separately from services whose place of supply is located in any Member State in accordance with any of such special cases, and to which they may be directly or indirectly related.

3. Article 33(2) of the Implementing Regulations

b. If the customer, who is receiving the Services,is resident in any member state.

c. If the customer, or any other person, benefits directly from the services when such customer or person is situated in a member state, and the other person is not permitted to deduct the input tax on such services in full.

d. If the services are performed in relation to tangible goods which are located within a member state during a supply.

4.3.3. This means that a supply of services by a bank or financial institution to a non-resident can be zero-rated except where any of the above exceptions apply.

4.3.4. In case any of the exceptions apply, the supply should not be subject to VAT at the zero-rate and the relevant VAT treatment applies to services supplied to "local" customers (either at the rate of 15% or exempt).

4.3.5. The details of these terms and their application to supplies made by banks is discussed below.

1. **The requirement that the place of supply of the services is not in any GCC member state pursuant to the special cases listed in Articles 17-21 of the Unified VAT Agreement:**
   Articles 17-21 of the Unified VAT Agreement provide a number of special place of supply rules applicable to services. Such rules apply to transportation services, services linked to real estate, catering services and other similar services, which are typically treated as supplied in the place where they are consumed or performed. The rules for services relating to real estate may be particularly relevant to services offered by KSA- resident banks.

4.3.6. Banks, which provide financial services connected to a specific area of real estate in KSA are supplying a service, linked to real estate. As such, zero-rating would be prevented on these services by this exception to Article 33.

4.3.7. **Example (1):** A KSA lender bank offers a financing product to a non-resident investor relating to a property situated in KSA. Since the service is related to a real estate in KSA and falls under the special place of supply cases, the bank would not be able to zero-rate such property-related services despite the customer's residency status.

2. **The requirement that the customer is not resident in a GCC member state:**
   In accordance with Article 33 of the Implementing Regulations, a supply of services can only be zero-rated if the customer is resident outside the GCC member states:

   - A legal person would generally have a place of residence in a GCC member state when it is either legally established, has its actual management center, or has a fixed establishment in a GCC member state.

   - A natural person, on the other hand, will generally be considered resident in a GCC member state if the person has his or her usual place of residence in a member state.

4.3.8. In practice, it would be expected that a taxable supplier should not be applying the zero-rate on its services unless there is evidence that the customer is resident outside the GCC member state. Therefore, it should be determined whether the customer is resident inside or outside the GCC member state based on the appropriate evidence obtained by the bank in this respect. Where a bank is unable to confirm that the customer is resident outside the GCC member states, the supply should not be zero-rated.

4.3.9. **Example (2):** A KSA bank opens a bank account for a German company. During the onboarding and registration process, the company provided a certificate of incorporation issued by the German authorities as evidence of its residency in Germany. The bank will be able to zero-rate its services to the company under Article 33 (1) of the Implementing Regulations unless any of the exceptions in clause (2) apply.

4.3.10 **Example (3):** A UK manufacturing company received a letter of credit from a KSA-resident bank for a purchase of raw materials from KSA. The UK Company has a branch in KSA, which is used as a cost center. The supply of the letter of credit by the bank cannot be zero-rated because the UK Company is resident in KSA through its branch.

3. **The requirement that the benefit of the service is not received in GCC member states:**

   The ability to apply the zero-rate under Article 33 will be lost if the customer, or any other person, benefits directly from the services when such customer or person is situated in a member state, and the other person is not permitted to deduct the input tax on such services in full.

4.3.11. Thus, although a non-resident customer might not have a place of residence in any of the GCC member states, the customer may still be directly benefiting from the services while that person (in the case of an individual customer), or an employee / representative of that person (in the case of a legal person) is present in KSA or one of the VAT implementing member states that have an electronic system linked with the KSA.

4.3.12. In other cases, a third person, rather than the customer, may receive direct benefit of the service in the member states (instead of the non-resident customer receiving that direct benefit). Thus, in case such other person is not permitted to deduct input tax on this service in full, the application of the zero-rate will not be permitted and the service supplied will be subject to VAT at the standard rate.

4.3.13. Where the benefit is directly received by a non-resident customer or their employee, while the customer or the employee are present in one of the GCC member states, the supplier is not able to zero-rate the supply. In these circumstances, it is irrelevant whether the customer, or anyone else, is able to deduct VAT, which would have been incurred on the supply in full.

4.3.14. **Example (4):** An Australian tourist in KSA uses a KSA bank to withdraw money from its account. The bank charges the tourist a fee for the withdrawal services. The bank cannot zero-rate these fees since the customer receives a direct benefit from the services in KSA.
Determining the location of a customer must be made on a case-by-case basis and with reference to all reasonably accessible facts. Most importantly, it should be noted that the exception will not be triggered if the presence of the customer or its employees in KSA does not result in a direct benefit to the customer. The exception will not apply in cases where the customers or the customer's employees' presence at the time of provision of services is not related to the provision of services.

4.3.15. **Example (5):** If the employees of a US company were in the GCC member states for reasons other than work (e.g. for tourism), then their presence would not impact the application of Article 33 in relation to the supply of services to the US company in the KSA since their presence would not relate to the supply made by the bank.

4.3.16. **Direct benefit to another person:** where a benefit of a service is provided in any of the GCC member state to another person,not a non-resident customer or the customer's employee, the supplier cannot zero-rate the supply under Article 33 unless that other person is eligible to fully deduct KSA VAT which would have been charged on the supply of the services.

4.3.17. **Example (6):** A KSA bank issues a loan to a French investment company (without any presence in the GCC member states), and charges fees for the loan. The investment company uses the borrowed funds to purchase shares in a KSA life insurance company. Although the KSA insurance company could be viewed to be receiving some secondary or ancillary benefit from the loan since the loan will enable the sale of its shares to the investment company, the insurance company does not receive direct benefit from the loan - which is provided to the French investment company (being the entity which actually receives the use of the borrowed funds). Consequently, the bank will zero-rate the loan fees to the French investment company.

4.3.18. **Example (7):** A resident bank in KSA contracts with a UK real estate development company for the purposes of issuing a letter of guarantee. Although the UK company directly contracts with and makes payments to the KSA bank, the bank issues the letter of guarantee in the name of the KSA subsidiary of the UK company - which is involved in business of buying and selling real estate in KSA and does not have the right to deduct input tax in relation to the supply of these services in full. Since the direct benefit of the bank's services (the letter of guarantee) was provided to a person in KSA (the subsidiary), and that person cannot recover input tax incurred in full, the exception to the application of the zero-rating under Article 33 will apply and the services will be subject to VAT at the standard rate.

4. **The requirement that the services are not performed on tangible goods located within GCC member states during the supply:**

4.3.19. A supply cannot be zero-rated if the services are performed on tangible goods located within a GCC member state during the supply. This applies to services, which physically affect tangible goods, or a service, which has known, and identifiable tangible goods as the central subject matter of the service.

4.3.20. Whether or not a bank provides services in relation to tangible goods located within a GCC member state will depend on the nature of the service in question.

5.Incentives provided to banks by credit card companies

5.1. Introduction

5.1.1. Within the framework of its business activities, major international credit card issuers and payment network operators are known to enter into contractual arrangements with KSA banks under which the banks are incentivized to use the card issuers' services.

5.1.2. In doing this, the credit cards issuers may undertake to pay rebates or incentive payments to banks in return for achieving certain operational targets - for example, in respect of the use of their payment network or for achieving a certain volume of issued credit cards.

5.2. VAT treatment

5.2.1. As banks receive payments from card issuers in the course of their economic activities, it is necessary to consider if the banks have output tax obligations in respect of these payments.

5.2.2. The VAT treatment of the incentives will depend on the contractual arrangement entered into by a credit card company and a bank. It is expected that these would fall into two major categories:

- Payments are consideration for a supply of services by the bank to the credit card company; or
- Payments are considered a settlement made by the card issuer to reduce consideration in respect of an earlier supply by the credit card company.

5.2.3. As discussed below, the above scenarios will result in different VAT outcomes. Therefore, it is important that the parties are able to consider and identify the legal and contractual position regarding the nature of the payment made by a credit card company to ensure that the correct VAT treatment is applied. This will include consideration of activities and obligations undertaken by both parties and the triggers for incentive payments made to the bank.

5.3. Supplies made by banks

5.3.1. Where a bank agrees to perform certain activities for the benefit of a credit card company in return for a payment, there will be a supply of a service by the bank to the credit card company. Payment arrangements could vary and could be conditional (based on a certain target being achieved by the bank).

5.3.2. For example, a bank may agree to carry out a marketing activity to promote a credit card issued by a certain credit card company in return for payment, with the amount of the payment depending on the volume of cards issued. In this scenario, payments received by the bank would be related to the bank's activities of increasing the overall volume of the cards issued by the bank. The bank will therefore be making a supply of promotional services to the credit card company, which would be taxable at the appropriate VAT rate.

5.3.3. Additionally, the payment does not relate to any earlier supply made by the credit card issuer to the bank (even if it is calculated by the card issuer and deducted from the amount previously owed). Assuming the supply is subject to VAT, the bank should issue a tax invoice in relation to this marketing service.

5.4. Adjustment of consideration for an earlier supply by the credit card company

5.4.1. On the other hand, credit card companies may provide discounts or rebates to banks in relation to services previously provided by them to banks.

5.4.2. In this context, ZATCA considers that a card issuer could grant an actual commercial discount in return for meeting predetermined volume targets (e.g., number of transactions or volume of network usage may provide a commercial discount). In these cases, the bank does not typically provide a service in respect of the discount provided.

5.4.3. Where the discount or rebate relates to an earlier supply made by a credit card company, this will constitute a retrospective adjustment to consideration for the earlier supply.

5.4.4. As a consequence, where the credit card company is a taxable person in KSA, it would be required to issue a credit note to reflect the adjustment to consideration, after which the credit card company may adjust the output tax originally reported in the VAT return.

5.4.5. Additionally, if the bank has previously deducted input tax on the original supply made by the credit card company (in case of a taxable person in the KSA), it must correct its input tax to reflect the input tax amount calculated on the change of consideration in the tax period in which the credit note is issued.[4]

4. Article 40 of the Implementing Regulations

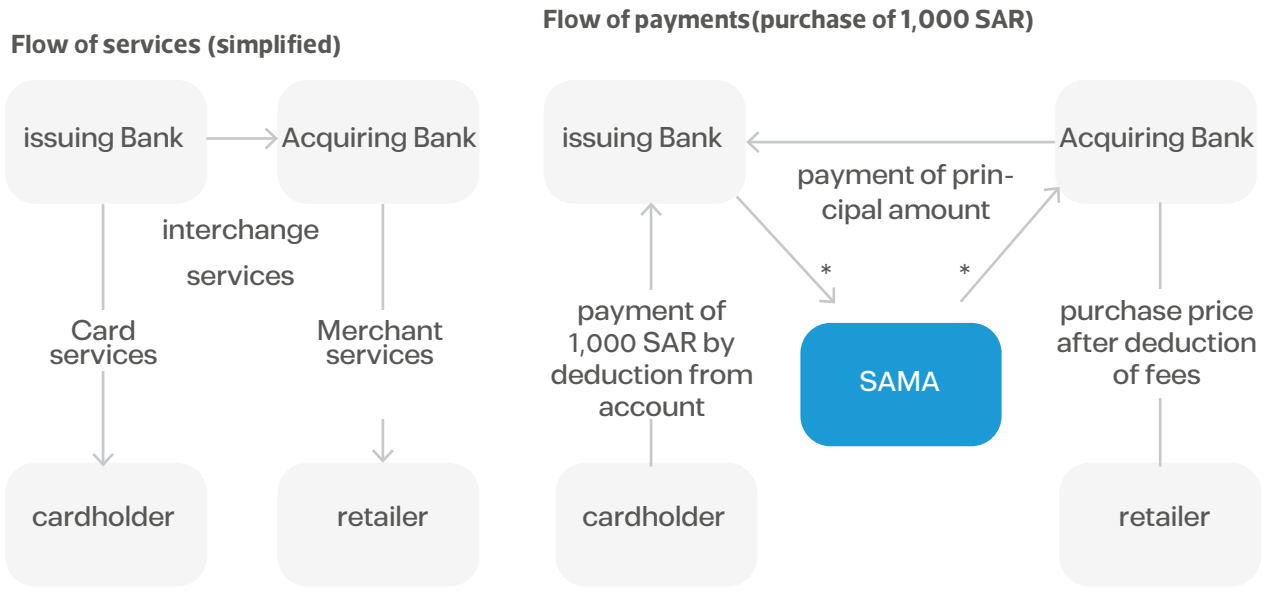
6.Interchange Services

6.1 .Overview of Interchange fees in the Banking Sector

Interchange fees are amounts paid by the Retailer's bank (Acquirer Bank) to a cardholder's bank (Issuing Bank) for the service provided by the Issuing Bank. In a transaction, where a customer purchases goods or services using a credit or debit card, five parties are involved in the transaction:

Cardholder	the holder of a card who purchases goods or services
Retailer/Merchant	the person who offers to sell goods or services and accepts payment amounts through payment cards
Issuing bank	the bank that issues a debit or credit card
Acquirer bank or POS bank	the Retailer's bank that accepts card payments and ensures that the Retailers are paid for every transaction
Payment Network Operator (PNO)	The payment network operator determines the percentage of internal exchange fees that are acceptable to both the issuing bank and the POS bank (Retailer's bank), and also receives fees for its services, in addition to verification services and use permits for transactions. In KSA, this is the Saudi Payments Network or "mada".

interchange fees



* Payment of interchange fee on a netted and consolidated basis

When a cardholder uses his card to make a purchase, the Retailer submits a request to the Acquirer bank to authorize the transaction. The Acquirer bank in turn forwards the request to the PNO to seek a confirmation of the card validity. Finally, the PNO sends a request to the Issuing bank to authorize the payment through the card number, transaction amount and card status. Once the Issuing bank authorizes the transaction, a confirmation is provided to the Acquirer bank (via the PNO) to process the transaction.

The PNO typically enters into separate agreements with the Issuing bank and the Acquirer bank. Under such agreements, the Issuing bank agrees to make payment to the PNO with respect to the authorized transactions (and receive interchange fees from the PNO in return of its services as part of the network). Furthermore, the PNO agrees to make payment to the Acquirer bank in respect of the authorized transactions (and in return receive interchange fees for its services). In all cases, the proportional deduction of input tax shall apply based on the variables of each case and in accordance with the provisions of Article 51 of the Implementing Regulations.

6.1.1. Interchange fees where the PNO, the Issuing Bank and the Acquirer Bank are based in KSA

The Interchange fee is consideration for a supply of services by the Issuing bank. Whilst interchange fees receivable and payable are often communicated to banks on a net basis, the Issuing Bank must determine the gross value of its supplies made to apply Output Tax to the appropriate amount.

Further information on interchange fees is detailed in the Financial Services Sector Industry Guideline (Version 1).

6.1.2. Interchange fees where the PNO is based outside of the KSA

ZATCA considers that, in arrangements where interchange fees are charged and collected by a non-resident PNO, the Acquirer Bank remains the service recipient. This means that zero-rating may only apply in circumstances where the Acquirer Bank is known to be a non-resident (notwithstanding the residence of the PNO.)

6.1.2.1. Interchange fees charged by the Issuing Bank for domestic operations through the PNO

Income received by an Issuing Bank from a non-resident PNO is consideration for services provided to the Acquirer Bank and the underlying merchant. If the income relates to merchants and their Acquirer Banks who are resident in a GCC State, this is consideration for a domestic supply of services and is not eligible for zero-rating. The place of residence of the PNO does not affect the application of VAT.

6.1.2.2. Interchange fees charged by the Issuing Bank in relation to foreign merchants

Income received by an Issuing Bank from a non-resident PNO, which relates to a merchant and Acquirer bank outside of the GCC States, is consideration for supplies made to a non-resident. The zero-rate may be applied to this income, provided that the remaining conditions of Article 33 are met. The Issuing Bank should also have adequate documentation to support any portion of revenue derived from a PNO which is supplied in relation to non-resident merchants and their Acquirer Banks.

6.1.2.3 Charges by an Acquirer Bank to a merchant

An Acquirer Bank charges fees known as a "merchant fee" to the merchants for use of the electronic point of sale facilities. Merchants are expected to usually be established in the same country as the Acquirer Bank, and if a merchant is in the same country as an Acquirer Bank, these services would be subject to VAT at the standard rate. If a KSA Acquirer Bank were to charge a non-resident merchant for use of point-of-sale facilities in the KSA, the facts would need to be analysed to determine if the zero-rate could apply in each case.

6.1.2.4 Charges made by a non-resident PNO

A non-resident PNO may charge authorisation, settlement, or other fees for its services to Issuing or Acquirer Banks. These services would be subject to VAT if charged to a Bank in the KSA, with VAT to be reported under the Reverse Charge Mechanism. It is important that the gross amount of the PNO's fees is separately identified for VAT purposes (and not offset against the gross value of Interchange fees earned by the Bank).

6.2 Illustrative example of how Interchange fees are applied in the banking sector

6.2.1. Interchange services provided by non-resident PNOs

Taxable persons in the banking sector engage in card payment systems (i.e., a centralized payment network that processes credit card and bank card payments according to a set of procedures, rules, and arrangements). The card payment system provides customers with the ability to use their credit cards and bank cards to pay for goods and services around the world. Such systems enable banks to connect with each other through a large number of transactions. Therefore, the systems act as a medium/intermediary to facilitate the payment process between the various concerned parties. Visa and MasterCard are considered as the largest card payment network operators for non-residents and provide banks with membership in the system. Under such membership, banks are responsible for managing and operating the platform and facilitating payment transactions between the various members.

This card payment system arrangement is generally referred to as "interchange" which is defined as the "standardized electronic verification of information and transfer of funds", with all banks participating in the system earning interchange fees (in the case of an Issuing bank) and incur interchange fees (in the case of an Acquirer bank), a credit card transaction is a carefully coordinated process involving multiple parties. To clarify this complexity, we will discuss a point-of-sale scenario involving the following parties: the card-issuing bank (the Issuing bank), the acquiring merchant bank (the Acquirer bank), the merchant, the cardholder, and the card payment network operators, with the role(s) of each party/parties being explained as per the following:

Issuing Bank:
The bank that issues a bank card and/or credit card to a customer who uses it to buy from a merchant.

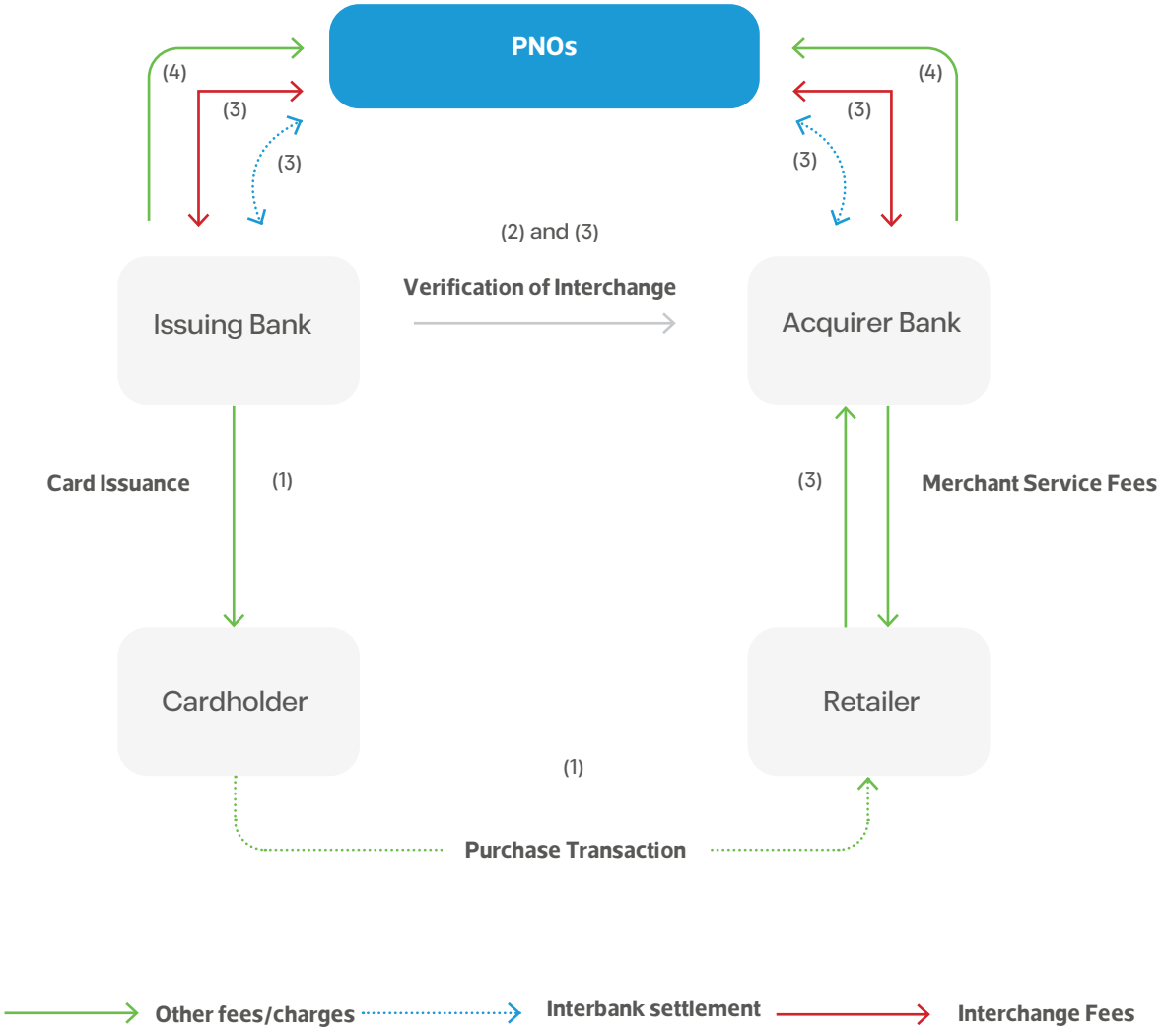
Acquirer Bank:
The bank that attracts/acquires merchants to accept card payments and ensures that they are paid for each transaction, hence called the Acquirer.

Retailer/Merchant:
Any entity that accepts bank or credit card payments.

Cardholder:
The legal owner of the card issued by the Issuing bank that makes a purchase using the card from a merchant.

Issuer and Acquirer:
For each transaction, the Acquirer bank verifies with the Issuer that the card and transaction amount are correct.

Card Payments Network Operators:
Network providers (particularly Visa and MasterCard) that manage and supervise the network which enables approval of transactions and transfer of payments between both banks (the issuer and the acquirer banks).


PNOs
(4)
(3)
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(4)
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(3)
(2) and (3)
Verification of Interchange
Issuing Bank
Acquirer Bank
Card Issuance
(1)
(3)
Merchant Service Fees
Cardholder
Retailer
(1)
Purchase Transaction
Other fees/charges
Interbank settlement
Interchange Fees

Step 1	**The issuer issues the card to the cardholder**. When a cardholder uses his card to purchase goods or services, the Retailer submits a request to the Acquirer bank to approve the transaction, which in turn forwards the request through the respective card payment network operators to the Issuing bank, which immediately checks whether the card number, transaction amount, and card status are correct, in addition to the following: • With respect to bank cards, if the transaction amount is not available in the card holder's account balance, the transaction will be rejected. If the transaction amount is available in the balance, the transaction will be approved. • With respect to credit cards, if the transaction amount is not within the limits of the credit or available balance of the cardholder's account, the transaction will be rejected. If the transaction amount is within the credit limit or available balance, the transaction will be approved.
Step 2	If the transaction amount is within the credit limit and balance of the credit cards and bank cards respectively, in addition to the card information validation, the Issuing bank sends an approval code to the respective card payment network operators, which in turn send it to the Acquirer bank to process the transaction. The cardholder then receives the goods and services from the Retailer.

Step 3	The Retailer stores all approved sales in one batch and sends the batch to the Acquirer bank at the end of the day to receive the payment.
Step 4	The Acquirer bank sends the batch through the card payment network operators to request the payment. At this point, a percentage of the transaction value (step 3) is deducted by the Acquirer bank as compensation for its services to the Retailer (i.e., the guarantee and payment transfer, formally known as the Merchant service fee). The Issuing bank will receive a report from the card payment network operators specifying the purchase price as well as the relevant interchange fee revenue value. The Issuing bank pays the card payment network operators according to its separate agreement with them, and the card payment network operators then pay the purchase price to the Acquirer bank according to their separate agreement. In return for granting network access and assisting in the settlement of funds, card payment network operators charge membership and administration fees to both the Issuing bank and the Acquirer bank.

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