



VAT GUIDELINES FOR THE OIL AND GAS SECTOR

1. Introduction

The General Authority of Zakat and Taxation (“GAZT”) issued earlier in May 2019 VAT Guidelines for Oil and Gas (“Guidelines”). The Comprehensive guidelines provide clarity on the VAT impact on various upstream, midstream and downstream activities carried out in the Oil and Gas Sector. As per the KSA VAT Law read with KSA VAT Regulations and the GCC Unified Agreement, the general principle is that the activities of the Oil and Gas sector are subject to VAT at the standard rate. This alert document summarises some key points.

2. Key terms that are used in the Guidelines

International Waters: This is not a defined term for VAT purposes. It is used in the guidelines to refer to any area of the sea outside of the territory of any country (under which neither the Kingdom nor any other country claims sovereignty).

Territorial Waters: This is not a defined term for VAT purposes. It is defined in the “*Law of Maritime Zones of the Kingdom of Saudi Arabia, Royal Decree M/6, dated 181433/1/ H*” to extend twelve (12) nautical miles from the coast of the legally adopted baseline of the maritime zone of the Kingdom in the Red Sea, Gulf of Aqaba and the Arabian Gulf (including the air space, layers under the soil and natural resources).

Pipeline Distribution System: This is not a defined term for VAT purposes. GAZT considers that this includes any integrated network of pipelines or similar infrastructure that can transport Oil and Gas from one stage of the supply chain to another, such as transmission networks, distribution networks, and associated facilities connected to those networks whereby refined oil or gas are distributed to distributors or consumers. By contrast, a single transmission pipeline used for transporting crude oil or gas to or from a refinery is not likely to be viewed as a pipeline distribution system.



Customs duty suspension situation: This refers to any of the Cases where customs duties and taxes are suspended in accordance with Section VII of the Common Customs Law.

3. Place of Supply

Supply of oil and gas is considered as the supply of goods. The standard rule of the place of supply is applicable.

Standard Rule of the place of supply of goods is that:

- If the goods are sold with transportation, the place of supply is the place where the transportation commences
- If the goods are sold without transportation, the place of supply is the place where the goods are made available to the customer on the date of supply.

As an exception to the standard rule, the place of supply for oil or gas through a pipeline distribution system by a Taxable Person in KSA to a Taxable Trader established in another Member State shall be the place where the Taxable Trader is established.

4. Supply of goods before Import or after Export

If a supply of oil and gas takes place before the import of goods into KSA, such supplies are out of the scope of KSA VAT.

If any supply of oil and gas takes place after the export clearance, but while the goods are still in KSA territorial waters, they can also be treated as export of goods and zero-rated.

5. VAT Impact on Upstream Activities

Upstream activities are concerned with the exploration, extraction, and production of oil and gas. All upstream activities are taxable at the standard rate, subject to the zero-rating conditions of export.

The Guidelines are as follows:

- a. **Exploration:** Such activities include the identification of hydrocarbon deposits and assessment of commercial and economic viability of extraction. Exploration activities are considered as economic activities and hence, the Taxable Person carrying out Exploration Activities has the right to deduct Input Tax, subject to the fulfilment of general conditions of the Input Tax.
 - i. **Unsuccessful Exploration:** Exploration activity is considered as an economic activity, irrespective of the result of the exploration. Therefore, even for unsuccessful exploration, the right to a deduction of input VAT exists, subject to conditions.



- b. **Development:** This involves the preparation of the site for production and establishment of the necessary infrastructure for production. Such activities are also considered an economic activity, as they are connected to the intended future taxable supplies of oil and gas. Input Tax is available for deduction, subject to the general conditions of Input Tax deduction
- c. **Production:** This involves the extraction of crude oil and gas from the ground, for the purpose of refining, processing or for immediate sale in an unrefined state. The subsequent sale from this stage may be domestic or export and will be taxable accordingly. Irrespective of whether it is export or domestic sale, input tax will be available to deduction, subject to the general conditions of Input Tax deduction.
- d. **Decommissioning:** This involves the removal of any infrastructure and the restoration of the site, after the completion of exploratory work or production. It is the last step in upstream activities. Even though decommissioning does not relate to any future supply, Input Tax paid on any inputs for decommissioning will be available for deduction, subject to the general conditions of an Input Tax deduction.

Any royalties, charged by the Government are treated as a Sovereign Supply and not a supply for the purpose of VAT, and are thus out of the scope of VAT.

Joint Operation in Exploration and Production

There may be instances where two or more companies form an association, which may lead to the creation of a separate legal entity, with or without an actual partnership or incorporation. The parties enter into a Joint Operating Agreement. In a Joint Operating Agreement, the party which oversees the operation and decision making is called the “Operator”. Other parties are called “non-operators”. The party acting as an operator may enter into third-party contracts in its own name (as an undisclosed agent) or in the name of others (disclosed agent). Depending on the method of entering the agreement, any recharge of costs by the operator will either be disbursement (not subject to VAT) or reimbursement (subject to VAT).

Cash Calls: There may be instances where the Operator may request for the payment of “cash calls”. If such a payment is for a future supply or reimbursement, it will be considered as an event of supply and will trigger the date of supply. If the payment is not allocated to any supply, the receipt of payment will not trigger the date of supply. Various situations and arrangements may exist and it is important to examine each carefully for implementation.

Transfer of Economic Activity: If any taxable person transfers the entire exploration activity (alienation of interest), along with all tangible and intangible assets, this is a transfer of economic activity and will not be subject to VAT, provided the conditions of transfer of economic activity under KSA VAT Regulations are met.

6. VAT Impact on Midstream Activities

Midstream activities can be viewed as a bridge between the (upstream) production of oil and gas and the (downstream) refining and marketing for general consumption. It typically involves sale and purchase of products, transportation, etc. The broad activities under Midstream Activities are as follows:



a. **Trading:** Trading of oil and gas is a supply of goods under KSA VAT. Each time the ownership in such oil or gas is transferred, it is considered as a supply. If the place of supply is KSA, it will be taxable to VAT at the standard rate, subject to the zero-rating for exports.

i. **Chain Transaction:** In certain cases, the ownership in oil and gas may change multiple times, with the goods remaining in the storage or in transit. In such a chain transaction, the physical possession of goods is not necessary. For example, if one Company purchases oil from a production Company, but instantly sells (including the transfer of risks and rewards) to its customer, the Company and the production Company are both making taxable supplies. The members in a chain transaction should carefully examine the taxability, based on the transfer of title in the goods and not the physical possession of goods. If one or more members of a chain transaction are international companies, i.e. non-residents in KSA, then such transactions should be zero-rated, subject to the conditions of export of goods.

Our Comment: *It is important to ensure that in trading (chain) transactions especially those involving the same parties full and correct discharge of VAT is made by all KSA taxable persons.*

ii. **Transactions with future delivery date:** There may be instances where the taxable person enters into certain contracts where the supply of oil and gas may take place at a later point in time. If there is any fee/consideration paid with respect to such contracts, it will be considered as a consideration for future supply and subject to VAT at the standard rate, provided the delivery takes place in KSA. There may be cases where such commodity trading is in fact, a financial trading, i.e. there is no intention to take ownership or possession of the goods, and contracts are more in the nature of financial derivatives contract and not the trade of the underlying commodity. Any consideration paid in such cases is exempt from VAT.

b. **Transportation of oil and gas:** Any consideration for transportation of oil and gas, whether by pipeline system or any other means of transport is considered as transportation of goods. The place of supply will be the place of commencement of transportation. The following table summarises the taxability of the transportation services:

Transport Origin	Transport Destination	VAT Impact (KSA)
KSA	KSA	VAT at 5%
KSA	Outside KSA	VAT at 0%
Outside KSA	KSA	Not subject to KSA VAT
Outside KSA	Outside KSA	Not subject to KSA VAT

Any ancillary service such as storage, handling, loading-unloading, export clearance, etc. will have the same taxability as the main transportation supply, i.e. if transportation is zero-rated, the ancillary service is also zero-rated.



Our Comment: Documents and contracts will have to be carefully examined to correctly assess the VAT treatment of the transactions.

7. VAT Impact on Downstream Activities

Downstream activities include the refining and distribution for general consumption. Refined products include hydrocarbons in a liquid or gaseous form which have been refined for use as a fuel, e.g. for heating, cooling, industrial use, or in any means of transport (most petroleum oils and gases in HS Code 2710 or 2711 (except 271111 & 271121)). The Guidelines for downstream activities are as follows:

- a. **Supplies for domestic consumption:** As per the general rule, all domestic supplies of oil and gas (for consumption within KSA) are taxable at 5%. The date of supply is the date of transportation (if supplied with transportation) or the date when the goods are placed at the customer's disposal. All compliances related to a general supply of standard-rated goods will be applicable in this case.
- b. **Call-off or reserve stocks:** In some cases, the supplier may place a stock of oil at a customer's premises wherein the ownership is transferred only when the customer withdraws the goods. In such cases, it is clarified that the date of supply is when the goods were placed at the customer's premises, irrespective of the date of transfer of ownership.
- c. **Supplies for Aviation and Marine fuel:** This is used in a qualifying means of transport and will be subject to VAT at zero rate. The basis for this is that it is a consumable incorporated into the vessel or aircraft. It is clarified that the taxable person must obtain a self-certification from the customer that the means of transport is used predominantly for international transportation and is not intended to be used for recreational or private use. This self-certification should be valid at the time of the uplift or delivery of fuel to the aircraft or vessel. There is no specified format for a self-certification, but it should refer to:
 - i. The registration number of the aircraft or vessel
 - ii. The date or dates on which the certificate is valid.

Our Comments

The supply, import or export of oil and gas is considered as supply, import or export of goods under the KSA VAT Legislation. As per the KSA VAT Law and Regulations, most of the activities undertaken in the oil and gas sector are subject to VAT at the standard rate of 5%, while few are zero-rated. The VAT treatment too is the same, i.e. zero-rated in most cases of export (subject to conditions), standard rated in most cases of import (subject to conditions).

These Guidelines on the Oil and Gas sector are welcome as they provide clarity in respect of various situations however, each transaction profile and the contractual terms will have to be carefully examined to correctly assess VAT and avoid any contraventions. These guidelines do not deal with some complex issues including deposits on returnable containers, exemptions to sub-contractors.



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