



## VAT in the United Arab Emirates

Draft VAT law released for January 2018 commencement

### Where are we today?

Six months following the **VAT Framework Agreement**, signed by each of the six Member States of the Gulf Cooperation Council (GCC), the United Arab Emirates (UAE) Government enacted and published its **draft domestic VAT law of 2017**.

The publication of the Law is the first step in the establishment of the complete VAT framework in the UAE. The VAT Executive Regulations are currently still in the process of being prepared and approved, and it is expected that they will be enacted and made public before the end of summer. Nevertheless, the publication of the Law marks the point of no-return of the UAE Government in respect of the introduction of VAT, and indicates that the Government is still serious regarding the introduction of VAT on 1 January 2018.

Furthermore, the publication of the Law provides businesses with substantial detail regarding the design of the UAE VAT regime. **So, what can businesses learn from the published Law?**

### Charging VAT

VAT is a transaction based tax which will be imposed on taxable supplies made by taxable persons and on imports into the UAE.

A person will be a “taxable person” if it is registered, or required to be registered, for VAT. Although registration thresholds are not specified in the Law, in line with the GCC VAT Agreement it is expected that **a person will be required to register for VAT if the value of their supplies or imports that would normally be taxed exceed the registration threshold of AED 375,000 during the period of the previous 12 months or are anticipated to be exceeded over the next 30 days**. Furthermore, a person would be able to register for VAT voluntarily if they do not exceed the mandatory registration threshold but exceed the voluntary registration threshold (which is expected to be AED 187,500). Interestingly, the Law indicates that the voluntary registration threshold may be calculated with reference to expenses which were subject to VAT – therefore, allowing start-up businesses to register for VAT as well.

It should be noted that there is no registration threshold for businesses which are not resident in the GCC. Therefore, any non-GCC business may be required to register for VAT if it make any supplies in the UAE. However, in circumstances where a UAE resident business is responsible for accounting for VAT on that supply (e.g. self-assess VAT under the reverse charge mechanism), the supply will be ignored for the purposes of the VAT registration of the non-resident. The standard rate of VAT will be 5%, as has been agreed by all Member States of the GCC. The standard rate will apply on most goods and services, unless they are specifically designated as zero-rated or exempt.

The Law provides a **list of supplies of goods and services that are to be zero-rated or exempt** from VAT.

VAT will be charged at 0% on the following main categories of supplies:

- Exports of goods and services to outside the GCC;
- International transportation, and related supplies;
- Supplies of certain air, sea and land means of transportation (such as aircrafts and ships);
- Certain investment grade precious metals;
- Newly constructed or converted residential properties;
- Crude oil and natural gas;
- Education; and
- Healthcare.

Furthermore, the following categories of supplies will be exempt from VAT:

- Certain supplies of financial services (to be specified by the VAT Executive Regulations);
- Residential properties;
- Bare land; and
- Local passenger transport.

The Law does not provide much additional information regarding the exact scope of the zero-rated and exempt supplies. It is expected that the VAT Executive Regulations will provide much more detail regarding the proposed rules in order to give business certainty regarding their application.

## VAT recovery

Any VAT registered business will generally be able to recover VAT incurred on purchases of goods and services (“input tax”) where those purchases are used or intended to be used for making taxable supplies (i.e. a supply subject to tax at 5% or 0%) or supplies which would have been taxable if made in the UAE. In contrast, no input tax will be recoverable if the purchase relates to non-taxable use – e.g. to making an exempt supply or for private purposes.

In the event an expense relates to both taxable and non-taxable supplies made by the business, the business will need to apportion input tax between such supplies. The VAT Executive Regulations will provide for a method that has to be used to perform such apportionments.

## Accounting for VAT

A VAT registered person will be required to file regular tax returns, which will outline the VAT charged by the person on supplies made during a tax period and VAT incurred by the person on expenses that the person seeks to recover. The difference between these amounts will be either the VAT payable by the person to the FTA or VAT refundable from the FTA to the person.

## Special rules

Based on the published Law, the following special rules will be part of the UAE VAT landscape:

- **Import of goods:** VAT will be payable by a VAT registered person on goods and services purchased from abroad, using a reverse charge mechanism (i.e. using its normal VAT return). A non-registered person will pay VAT at the time of import of any goods from a place outside the GCC. There are special rules for goods destined for transshipment to another GCC country via the UAE.
- **VAT Group:** two or more persons carrying on a business will be able to apply for a single VAT registration as a VAT Group regime. As a consequence, they will be treated as a single taxable person for VAT purposes.
- **“Designated zone”:** being areas to be designated by the Cabinet which will be treated as being outside the UAE for VAT purposes. It is expected that the rule may apply to some of the freezones. The Law does not cover this topic in much detail and it is expected that the Executive Regulations will provide much needed further information on the treatment of such designated zones.
- **Financial services:** the Law specifies that certain financial services may be exempt. On the basis of awareness sessions conducted by the Ministry of Finance earlier this year, it is expected that fee-based financial services will be taxed at 5% but margin-based products are likely to be exempt. Furthermore, to avoid discrepancies in VAT treatment between internationally standard financial products and Islamic Finance products, the treatment of the latter is expected to be aligned with the treatment of similar standard financial services.
- **Profit margin:** under certain circumstances, a business will be able to calculate and charge VAT with reference to the profit margin earned in respect of a taxable supplies, rather than on the value of the supply. The Executive Regulations will provide further details regarding how and when the rule can be used, but it is expected to apply to sale of second-hand goods.
- **Bad debt relief:** subject to certain conditions, where a business charged VAT and paid it to the FTA but the customer has not paid the supplier and the amount has been written off as debt, the business will be able to make a claim to the FTA for VAT that relates to the written off amount.

## VAT refunds

In addition to VAT refunds that may be payable to a VAT registered business as specified above, the Law contemplates a number of other situations where a refund of VAT may be given to an individual or a business. They include VAT refunds to:

- a resident of the UAE for goods and services relating to constructing a new residence;
- a non-GCC business which is not a taxable person in the UAE;
- a non-resident for purchased goods that will be exported;
- foreign governments, international organisations, diplomatic bodies and missions according to treaties that the UAE is a party of;
- any other class of Person listed in a decision issued by the Cabinet.

Further detail regarding these refunds will be provided in the Executive Regulations.

## Transitional periods

The Law addresses the potential issue of contracts which span implementation, providing that contracts relating to supplies made post-implementation will still attract VAT regardless of when concluded, and that prices quoted in such contracts may be treated as VAT inclusive if not otherwise stipulated. In some situations, this could mean that the supplier must treat any consideration under the contract as being inclusive of VAT, therefore reducing its profit margin. The Law mentions that detailed provisions around contracts spanning implementation will be included in the executive regulations, which we would expect to cover which contracts might be treated as VAT inclusive and those which might carry the right for VAT to be added. Based on awareness sessions held by MoF previously the expectation is that this will be possible where the customer is able to deduct the VAT payable.

## Getting ready for VAT

In the coming months, actions to build towards a VAT ready state should include:

- Reviewing whether systems capabilities meet standards required by local tax authorities, particularly regarding reporting and invoicing
- Introducing and documenting VAT policies, procedures and controls—especially for accounts payable and accounts receivable functions
- Planning for transition periods can often involve determining systems are capable of recognizing more than the standard number of tax rates
- Supply chain enhancement aimed at reducing adverse VAT cash flow impacts
- Restructuring where necessary to determine minimal VAT ‘leakage’ occurs
- Understanding the impact of VAT on pricing and working capital requirements
- Securing budget through a business case and your place in line with IT to manage systems changes

## Immediate action

The announcement of draft law is a further reason for businesses to accelerate their VAT readiness preparations. Preparation is key because VAT liabilities are generally self-assessed, with errors often subject to severe penalties and time consuming interactions with local tax authorities, or worse, causing a business disruption.

Immediate actions, if not already completed, should be to:

- Assess VAT readiness with GCC VAT Review Smart (VRS), Deloitte’s online assessment tool, which considers everything from the financial impact of VAT, through to staffing and accounting process
- Develop roadmaps through to early 2018 and develop a resourcing plan to identify the work necessary to be ready to submit VAT returns in 2018
- Engage in dialogue with industry groups and authorities surrounding any high-impact or complex areas of law
- Map your transaction footprint to determine all future VAT liabilities and compliance obligations are easily overlaid
- Review and update contractual arrangements with vendors and customers to determine each party is aware of its responsibilities for paying and accounting for VAT
- Include appropriate caveats in contracts and implement changes to contractual terms, where required

### Middle East VAT Services

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