WATSON FARLEY
&
WILLIAMS

BRIEFING

# VAT IN THE UAE
# COUNTDOWN TO 1 JANUARY 2018

SEPTEMBER 2017

- VAT BECOMES EFFECTIVE IN THE UAE ON 1 JANUARY 2018.
- ALL TAXABLE PERSONS ARE REQUIRED TO REGISTER IN THE THIRD QUARTER OF 2017.
- THE VAT LAW INTRODUCES A STANDARD RATE OF 5% BUT WITH ZERO AND EXEMPT RATED CATEGORIES OF SUPPLIES AND GOODS.
- THE VAT LAW REQUIRES ENHANCED FINANCIAL RECORD KEEPING AND REPORTING OBLIGATIONS IN THE UAE.

The much awaited law on the introduction of Value Added Tax ("VAT") in the United Arab Emirates ("UAE") has now been published. Federal Law No. 8 of 2017 (the "VAT Law") follows on from Federal Law No. 7 of 2017 on Tax Procedures (the "Tax Procedures Law"). The VAT Law is a development on the Tax Procedures Law but is not the final piece of the VAT jigsaw in the UAE.

As we write this, businesses in the UAE await the release of "Executive Regulations" that will further define and specify the scope of VAT and its application in the UAE. In this briefing, we summarise our current understanding of the VAT Law and identify areas of concern which UAE businesses and other taxable persons falling within the scope of the VAT Law should be considering in readiness for the 1 January 2018, the date the law comes into effect.

## Summary of VAT as it applies to the UAE

### 1. Rate

A VAT rate of 5% will apply. This is an alignment with the standard VAT rate agreed amongst the member states of the Gulf Cooperation Council.

### 2. Exempt or zero-rated transactions

VAT will be applied on the supply of all goods and services <u>except</u> the following principal goods and services which are exempt or zero-rated:

| TYPE OF GOODS OR SERVICES | EXEMPT OR ZERO RATED |
|---|---|
| The supply of any margin-based services provided by the financial services industry | Exempt |
| The supply of life insurance | Exempt |
| The supply of education and related services by institutions funded by the UAE authorities | Zero |
| The supply of basic and preventative healthcare | Zero |
| The supply of residential accommodation for rent | Exempt |
| The supply of new residential accommodation | Zero |
| The supply of local transport | Exempt |
| The supply of specified oil and gas products | Zero |
| The supply of international transport | Zero |
| The supply of investment precious metals | Zero |

“ANY TAXABLE PERSON (THIS INCLUDES BOTH BUSINESS ENTITIES AND INDIVIDUALS) SUPPLYING TAXABLE GOODS OR SERVICES EXCEEDING AED375,000 ANNUALLY MUST REGISTER FOR VAT WITH THE FEDERAL TAX AUTHORITY.”

Zero-rated means that no VAT is charged on the supply and the supplier can recover any related input VAT. Exempt rated means that no VAT is charged on the supply, however the supplier cannot recover any related input VAT.

There has been speculation in the UAE press that certain staple food items will be exempt or zero-rated, though the VAT Law does not specify this.

### 3. Registration

Any taxable person (this includes both business entities and individuals) supplying taxable goods or services exceeding AED375,000 annually must register for VAT with the Federal Tax Authority ("FTA").

A business supplying taxable goods or services exceeding AED187,500 but below AED375,000 may voluntarily register for VAT with the FTA.

Electronic registrations (click here for more information) will be open from the third quarter of 2017 and businesses must register prior to 1 January 2018.

Non–resident businesses do not need to register for VAT unless they make taxable supplies of goods and services within the UAE.

### 4. Designated Zones

The VAT Law introduces a concept of "Designated Zones" which remains undefined at present. Our understanding is that goods may be transferred from one Designated Zone to another without incurring VAT. Designated Zones are not to be confused with free zones but rather a Designated Zone will be akin to a bonded warehouse, being a secured area in which dutiable goods may be stored without payment of duty. Further details are anticipated in the Executive Regulations.

“THE VAT LAW ENHANCES CURRENT UAE LAW ON MAINTAINING FINANCIAL RECORDS AND OBLIGES ALL VAT-REGISTERED BUSINESSES TO MAINTAIN RECORDS OF TAX INVOICES, CATEGORISE SALES INTO ZERO-RATED, EXEMPT RATED AND 5% RATED SALES AND DOCUMENT INTER-COMPANY SALES.”

## 5. A new era of book keeping in the UAE

The VAT Law enhances current UAE law on maintaining financial records and obliges all VAT-registered businesses to maintain records of tax invoices, categorise sales into zero-rated, exempt rated and 5% rated sales and document inter-company sales. Records will need to be maintained for a five year period and capable of audit by the FTA and VAT returns to be submitted to the FTA on a quarterly basis.

### Key issues to consider:

#### Review transitional arrangements

Businesses need to look ahead and revise their contracts and invoice statements relating to the supply of goods and services on or after 1 January 2018, or where payment for such goods or services will occur on or after the same date. These transactions, among others, will attract VAT (unless exempt or zero-rated) and, accordingly, provision should be made under existing contract and invoice arrangements to charge VAT.

#### Group registration

The VAT Law introduces a concept of Group Registration. Two or more persons conducting business may register as a "Tax Group" if they are related parties, there is common control and each person has a fixed establishment in the UAE. The benefits of being grouped together for tax purposes include:

(i) Lower administrative costs as a Tax Group may submit consolidated returns and separate returns are not required for each member of the Tax Group; and

(ii) A VAT exemption on the supply of goods and services from one member of the Tax Group to another.

We await the Executive Regulations to clarify whether management control (common where a limited liability company is controlled by a foreign shareholder) is sufficient to meet the definition of "related parties" and “common control”. It will be interesting to see how nominee structures (typical in the context of limited liability companies registered outside the UAE's free zones) will be treated for the purposes of forming a Tax Group.

Businesses operating in the UAE may also wish to consider reorganising their ownership structures, consolidating control and, in some instances, winding down dormant operations in order to make their UAE operations more efficient from a VAT reporting perspective. Likewise, distribution channels and market entry for the supply of goods and services in the mainland UAE may need to be reviewed carefully in light of the Executive Regulations and updated to include VAT costs.

#### Property ownership

As VAT will apply to the sale and lease of commercial real estate, individuals who own commercial real estate in their personal capacity and earn rental income within the VAT threshold will be required to register for VAT. This may not be attractive i.e. it will give rise to personal liability on the property owner to file VAT returns and to account for VAT.

“THE REQUIREMENT TO FILE VAT RETURNS ON A QUARTERLY BASIS AND TO MAKE PAYMENT TO THE FTA PLACES THE EMPHASIS ON PAYMENT TERMS IN THE UAE.”

Hence, consideration may need to be given to: (i) transferring commercial real estate ownership into a corporate structure (which in itself will currently attract a property transfer fee unless the concept of VAT relief is introduced); or (ii) appointing letting agents to manage income receipts and VAT payments in order to relieve individuals (in some instances organised as family offices) of the regulatory burden. Note, guidance is also necessary from the FTA to determine the treatment of Jebel Ali Free Zone offshore companies which are commonly used to hold Dubai real estate. Will such companies be eligible for VAT registration and will they be allowed to trade with suppliers for VAT purposes?

### Credit and payment terms

The requirement to file VAT returns on a quarterly basis and to make payment to the FTA places the emphasis on payment terms in the UAE. Businesses will want to avoid the negative cash flow implications of delayed payments from customers whilst having to make VAT payments to the FTA. Hence, we anticipate tighter credit terms being applied in the UAE and more active management of debtor days.

### Summary

The VAT Law poses a number of serious questions for consideration and we strongly recommend UAE businesses review their operations now to avoid any delay in compliance with the 1 January 2018 deadline.

Watson Farley & Williams’ Dubai Corporate team would be delighted to discuss any aspect of the VAT Law and its implementation with interested parties.

## FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

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