

# inBrief



## VAT and Excise Tax

By Bashir Ahmed and Vivek Agrawalla | October 2017

The UAE has issued substantive law on Value Added Tax (VAT) and Excise Tax.

Federal decree law No.8 of 2017 deals with VAT. The imposition of VAT will commence in the UAE from **1 January 2018** at a rate of 5%. The VAT law provides a framework for implementation of VAT in the UAE. Many operative provisions specific to the UAE are not incorporated in the VAT law and instead will be disseminated in both the Executive Regulation and the Cabinet Decision to be issued in relation to the VAT law. Once issued, we will receive guidance on a number of areas which currently remain unlegislated. In the meantime, this inBrief deals with the provisions of the VAT law and information otherwise available in the public domain.

### Tax Registration

Registration is mandatory for any taxable person/business if the total value of its taxable supplies made within the UAE exceeds the mandatory registration threshold of AED 375,000 over the previous 12 months period or, if it is anticipated that the taxable supplies will exceed the threshold in the next 30 days.

Voluntary registration is available for taxable persons/businesses that do not meet the mandatory registration threshold, but exceed the voluntary registration threshold of AED 187,500 subject to the same taxable supply tests above.

A taxable supply refers to a supply of goods or services made by a business in the UAE that may be taxed at a rate of either 5% or 0%. Reverse charged supplies and imports are also taken into consideration for this purpose, if a supply of such imported goods and services would be taxable if it were made in the UAE.

Entities which are not based in the UAE but provide goods or services in the UAE are also required to apply for registration if they meet the threshold requirements.

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Registrations will commence in the fourth quarter of 2017 via the Federal Tax Authority (the **FTA**) website.

### **Exempt and Zero Rated Items**

The supply by a taxpayer of either an Exempt or Zero Rated good or service will result in no imposition of VAT on that transaction. Although the result of both categories of supply seems identical, these terms are not to be used interchangeably.

The key distinguishing feature between the two supplies is that a supplier of a Zero Rated good or service will be able to claim a refund on any VAT paid on their purchases (input tax) whilst a supplier of an Exempt good or service will be unable to recover any VAT paid on their purchases.

VAT law provides a list of Zero Rated and Exempt supplies. The list includes:

#### Zero Rated Supplies

- Exports of goods and services outside the GCC;
- International transportation and related services;
- Supplies of certain sea, air and land means of transportation (such as aircraft and ships);
- Certain investment grade precious metals of at least 99% purity (e.g. gold, silver and platinum);
- New residential properties that are supplied for the first time within 3 years of their construction;
- Supply of certain education services, and supply of relevant goods and services;
- Supply of certain healthcare services and supply of relevant goods and services;
- Supply of crude oil and natural gas.

#### Exempt Supplies

- Certain financial services including sharia compliant products;
- Residential properties (save those which are zero rated);
- Bare land;
- Local passenger transport.

### **Tax Grouping**

VAT law provides for tax grouping which allows companies with common control and / or ownership to be combined together into one entity for the purposes of VAT. Only one VAT registration number will be issued to the group and a combined VAT return will be required to be filed for the group, resulting in a simplification of VAT administration.

Members of a VAT group become jointly and severally liable for each other's VAT liabilities and no VAT will be payable on transactions among entities within the group.

### **VAT Interactions within the GCC**

Generally a VAT registered customer must account for VAT paid in respect of purchases however certain transactions between entities within the GCC will be subject to VAT by Reverse Charge.

The concept of reverse charging VAT allows the simplification of transactions within a single market (i.e. GCC states). The Reverse Charge removes the obligation to account for the VAT on a sale from the supplier, and places it on the customer. It is a concessional relief measure to assist the FTA with its administration so that foreign businesses do not need to register for VAT.

When a transaction is subject to Reverse Charge, and if your customer in another GCC country is VAT registered, then you will not be required to charge local VAT.

The customer will Reverse Charge VAT (i.e. account for VAT on your behalf) on their VAT return in their GCC country whilst simultaneously claim a VAT refund for the VAT paid on the purchase on the same return (if appropriate).

For the vendor it will effectively result in a Zero Rated transaction, with full entitlement to a refund of any VAT paid locally and no further obligation to account for the transaction.

If a GCC customer is not VAT registered (e.g. a private consumer) then reverse charging does not occur and UAE VAT would be charged until the vendor exceeded the AED 375,000 registration threshold in that GCC jurisdiction, at which time VAT registration would be required.

Note that for the purposes of a single market (GCC) VAT treatment, only those countries will be taken into account that have implemented VAT at the relevant time; the non-implementing countries would be treated like any other foreign country.

### **Application of VAT in UAE Free Zones**

VAT law does not provide guidance to the application of VAT within any of the free zones in the UAE. It is expected that the Executive Regulation to the VAT law will specify the tax treatment of free zone entities.

### **VAT Compliance**

Registered entities will be required to maintain records for at least a five year period.

Tax invoices issued are required to be denominated in Arab Emirate Dirhams (AED) and if a currency conversion is required to AED, only approved rates scheduled on the UAE Central Bank website may be used.

VAT returns will be required to be completed with summary level data and filed online via the FTA portal. Reporting of Emirate level sales data will be required, summarized per Emirate. This statistical information is important for each Emirate, as revenue from the implementation of VAT will be distributed between the Federal Government and each Emirate. All communications with the FTA will also be facilitated online via the same portal.

The VAT law provides for penalties (imprisonment and/or fines) for contravention of the provisions of the VAT law. Penalty rates have not been set and will be specified by Cabinet Decision. Late returns and errors on VAT returns will be penalized on a tax liability due basis, whilst compliance failures (e.g. persistent non lodgment of VAT returns) will be penalized on a fixed penalty per infraction.

### **Excise Tax**

Federal decree law No.7 of 2017 deals with Excise Tax and became effective in the UAE as of **1 October 2017**. A reasonably high rate of tax on a limited number of goods is imposed by way of an excise tax. This includes a 50% excise on carbonated drinks and a 100% excise on energy drinks and tobacco products. It is clear from the items on which excise has been applied that it is a tax to change social behavior by discouraging consumption of such products.

### **Conclusion**

The introduction of Excise and Valued Added Taxation are likely to change the way business is conducted and administratively maintained in the UAE and the GCC. This is a paradigm shift in a region which was largely free of taxation and the associated tax infrastructure. Although the rate of VAT imposition is set at a low 5% initially, and as such its effect economically will not be severe, the development and eventual maturity of a tax regime will have a much more pronounced effect on the economy and businesses alike. ■

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