NEW UAE VAT AND TAX PROCEDURES LAWS

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INTRODUCTION

As of 1 January 2018, value added tax ("**VAT**") at the rate of 5% will be applied on a wide range of goods and services in the United Arab Emirates ("**UAE**"). This follows from the Gulf Cooperation Council's ("**GCC**") entry into a GCC VAT treaty (the "**GCC VAT Treaty**") earlier this year, the UAE's publication of Federal Law No. 7 of 2017 on Tax Procedures (the "**UAE Tax Procedures Law**") in July and Federal Decree-Law No. 8 of 2017 on VAT (the "**UAE VAT Law**") in August. These developments are part of the GCC's initiative to introduce new sources of revenue for its member states.

The UAE VAT Law sets out the principles for the application of VAT, however it leaves much of the detail to the as yet unpublished Executive Regulations of the UAE VAT Law (the "**Executive Regulations**"). The Executive Regulations are expected to be issued in the near future by the Ministry of Finance. Further clarification may also be set out in executive regulations to be issued pursuant to the UAE Tax Procedures Law.

VAT FAQS

What is VAT?

VAT is a tax imposed on the "value" of the supply or import of various goods and services; it is not levied on profit or income. It is seen as a "neutral" or "indirect tax" as businesses essentially collect tax for the government and it is the end consumer who ultimately bears the financial burden of VAT.

VAT is imposed at each stage of a supply chain. A simplified example would be the case of a manufacturer who pays 5% VAT on raw materials. That manufacturer then assembles a product for sale to its customer, a household consumer. The customer will pay a purchase price that includes the manufacturer's cost (cost of the raw materials, assembly cost and manufacturer's profit margin) and 5% VAT. The manufacturer collects VAT from the customer for remittance to the government, but can recover the VAT it pays for the purchase of raw materials by offsetting the VAT paid for raw materials against the VAT received from the customer.

The UAE VAT Law describes the nature of supplies and imports that are subject to VAT, as well as the calculation of the taxable value of such supplies and imports.

What will be the VAT tax rate imposed in the UAE?

The UAE VAT law provides for a uniform VAT tax rate of 5%. This is in line with the tax rate adopted in the GCC VAT Treaty.

Will there be exceptions?

Yes, the supply of some goods and services will be 'exempt' or 'zero-rated', meaning that no VAT will be charged. The main difference between an exempt and zero-rated supply is that: (i) businesses making exempt supplies are not able to recover any VAT that they pay on the goods and services related to such exempt supplies ("**input expenses**"); whereas (ii) businesses making zero-rated supplies are able to recover VAT paid in relation to input expenses, if applicable.

Examples of some exempt and zero-rated goods and services referred to in the UAE VAT Law are included below:

exempt supplies - the supply of certain financial services (to be specified in the Executive Regulations), residential buildings through sale or lease (unless they are zero-rated), bare land and local passenger transportation; and

zero-rated - direct or indirect exports to countries outside of the GCC, transportation of goods and persons by land, air or sea, supply or import of investment-grade precious metals, the initial sale of a newly built residential building within three years of its completion, the initial sale of buildings specifically designed for use by charities and of buildings converted from non-residential to residential use, the supply of crude oil and natural gas, the supply of educational services by institutions that are government owned or funded and the supply of preventive and basic healthcare services.

Will VAT apply in the UAE's free zones?

It is unclear how the UAE will treat supplies made in free zones. The UAE VAT Law introduces the concept of "**Designated Zones**" and defines a Designated Zone as any area designated as such by a UAE Cabinet decision (at the recommendation of the UAE Minister of Finance). It remains to be seen whether the Executive Regulations will clarify whether some or all free zones will be Designated Zones, or whether the UAE Cabinet will issue separate decisions in this respect.

Designated Zones will be treated as being outside of the UAE for VAT purposes. The UAE VAT Law states that goods may be transferred from one Designated Zone to another without any VAT becoming payable. The Executive Regulations will set out the conditions under which business conducted within a Designated Zone will be considered as being conducted within the UAE for VAT purposes. The Executive Regulations are expected to set out the procedures and conditions for the transfer of goods to and from a Designated Zone, as well as the required method for keeping, storing and processing such goods in Designated Zones.

What businesses will be affected?

Pursuant to the GCC VAT Treaty and the UAE VAT Law, VAT will be collected by a "**Taxable Person**", which includes individuals, companies and partnerships conducting "Business" and supplying taxable goods or services. Taxable Persons are responsible for registering with the UAE's Federal Tax Authority ("**FTA**"), charging, collecting and paying VAT to the FTA and for all VAT-related record keeping and filing.

The UAE VAT Law defines "Business" broadly to include any on-going and regular commercial, industrial, agricultural and professional activities or services, as well as excavation activities or any activities related to the use of tangible or intangible property.

What are the penalties for non-compliance?

The UAE VAT Law provides that tax evasion is subject to the penalties set out in the UAE Tax Procedures Law. Amongst other consequences, the UAE Tax Procedures Law provides for the imposition of a prison sentence and/or a monetary penalty not exceeding five times the amount of the evaded tax. This is in addition to any other penalties applicable under any other law.

When is the UAE VAT Law coming into effect?

The UAE VAT Law will come into effect as of 1 January 2018.

How should businesses prepare for VAT implementation?

Registration

Businesses, as well as certain governmental entities to be determined by a UAE Cabinet decision, that are Taxable Persons will be expected to register with the FTA and obtain a tax registration number. The system for these registrations is expected to be available within the next month.

The GCC VAT Treaty sets out the following registration thresholds for businesses in the GCC:

mandatory registration - businesses with annual supplies in a GCC country exceeding or expecting to exceed AED 375,000 (or c. US$ 100,000) are required to register with the relevant state's tax authority (i.e. the FTA); and

voluntary registration - businesses with annual supplies in a GCC country exceeding or expecting to exceed AED 187,500 (or c. US$ 50,000) may, but are not obliged to, register with a tax authority.

The UAE VAT Law states that the mandatory and voluntary registration thresholds applicable in the UAE will be set out in the Executive Regulations.

To register for VAT, the above thresholds must: (i) have been exceeded in the past 12 months; or (ii) be expected to be exceeded in the next 30 days. The UAE VAT Law further provides that voluntary registration is permitted in cases where a Taxable Person's expenses exceed the voluntary registration threshold. This should benefit start-ups whose expenditures may initially exceed taxable supplies. The main advantage of voluntary VAT registration is likely to be that it will allow registered businesses to apply for tax refunds or offset VAT on input expenses.

Administrative processes

As noted above, the UAE Tax Procedures Law and UAE VAT Law refer to executive regulations which have yet to be published, but which should provide further detail on various issues including registration with the FTA, Arabic language requirements for VAT invoices and records, and the appointment by businesses of legal representatives to serve as contact points with the FTA.

VAT-related record keeping

The UAE VAT Law requires Taxable Persons to keep certain records including, by way of example, records of all supplies and imports of goods and services, all tax invoices and other documents related to receiving goods or services, all tax credit notes and all records of any goods or services that have been exported. Businesses should take steps to put in place adequate document collection and record keeping systems by 1 January 2018.

Review of contracts and record retention

Businesses should review existing contracts and arrangements with both suppliers and customers for clarity as to whether costs are currently inclusive or exclusive of VAT. New contractual terms may be needed to prevent businesses from incurring VAT-related losses. General terms and conditions and standard contracts should also be amended accordingly.

The UAE VAT Law sets out a list of the categories of records that must be kept. The GCC VAT Treaty refers to a record retention period of not less than five years, while the required retention period in the UAE will be set out in the Executive Regulations. It remains to be seen whether the record retention period under the UAE VAT regime will match or exceed the period set out in the GCC VAT Treaty.

Intra-group supplies

Issues such as tax grouping and tax liabilities of corporate groups will also need to be examined. The UAE VAT Law allows two or more related businesses to apply to the FTA for registration as a "tax group" provided that they meet certain conditions, such as being related parties and being each legally established or having a fixed place of business in the UAE. A "tax group" will be treated as a single Taxable Person. This means that intra-group transactions will not be subject to VAT.

UAE businesses should familiarise themselves with the new VAT regime immediately and start putting in place appropriate systems and controls to ensure that they are fully compliant with the UAE VAT Law by 1 January 2018. Publication of the Executive Regulations will help guide this process and allow businesses to manage the impact of VAT on their operations.

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