COUNTDOWN TO VAT IN THE UAE

By now, most people and businesses in the UAE should be aware that Value Added Tax (VAT) will be applicable in the UAE from 1 January 2018 at a standard rate of 5%.

Earlier this year, Federal Law No 7 of 2017 on Tax Procedures (Tax Procedures Law) was released, paving the way for this new regime, and the much anticipated VAT Law itself (Law No 8 of 2017 on Value Added Tax) was issued in late August. All that remains is the promulgation of the Executive Regulations related to each of the Tax Procedures Law and the VAT Law, which we expect to provide further detail of how VAT will be implemented in practice.

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While preparations should be well underway for all businesses that are required to register for VAT purposes, we take a look at some of the general practicalities that VAT-registered businesses (VRBs) should consider.

Zero rated and exempt supplies

Certain categories of supply are zero rated (meaning that no VAT is to be charged to customers but the supplier may reclaim all VAT on costs it incurs that attract VAT) such as the first supply of residential buildings within 3 years of completion, the supply of crude oil and natural gas, the supply of certain educational services and the supply of preventative and basic healthcare services.

Other categories of supply are exempt from VAT (meaning that no VAT is to be charged to customers which prevents the supplier from reclaiming VAT on costs linked to the supply that is VAT exempted) such as supply of financial services, supply of bare land and supply of local passenger transport.

Should you register?

The VAT regime applies to all “Taxable Persons”, defined in the Tax Procedures Law as “a (natural or legal (e.g. corporate)) Person who is subject to Tax under the provisions of the relevant Tax Law”.

All individuals, partnerships and businesses with an annual supply in excess of AED 375,000 will be required to register online with the Federal Tax Authority (FTA) to obtain a VAT registration number. All VRBs required to register must do so before 1 January 2018.

For those VRBs generating an annual supply of between AED 187,500 and AED 375,000, registration will be voluntary. There are certain tax breaks available to VRBs that may make it financially attractive for smaller businesses to register voluntarily.

For those VRBs with an annual turnover of less than AED 187,500 registration is not currently required.

The Ministry of Finance has provided some helpful general information on its website www.mof.gov.ae. The FTA website www.tax.gov.ae has further information and is the place to register your business for VAT when the on-line registration process commences, currently anticipated to be mid-September 2017.

Free zones

At the moment, it is not clear whether VAT will be applicable across the UAE or only outside free zones which are designated business areas in which special commercial laws and regulations may apply. The GCC Unified Agreement for VAT, pursuant to which the GCC members are implementing VAT, largely overlooks free zones, leaving this issue to be addressed by the individual member states.

The UAE’s VAT Law recognises the possibility of ‘Designated Zones’ which will be treated as outside the UAE for the purposes of the VAT Law, but leaves it to the Executive Regulations (which have not yet been released) to provide further explanation.

For now, however, free zone entities should also anticipate being subject to the Tax Procedures Law and the VAT Law (and, when published, the Executive Regulations) and plan accordingly.

General Administration for VRBs

All VRBs should co-ordinate VAT compliance across their entire business and review each part of their business in a timely manner to ensure VAT compliance and to avoid fines or other penalties for late registration or non-compliant systems once the VAT regime is implemented.

Robust accounting systems and processes will be key to managing VAT successfully. VRBs should ensure that their accounting software can be adapted to account for VAT and, in turn, invoices can be updated to show, amongst other things, the VAT registration number (when obtained) and the VAT charged on goods and services.

The FTA is to prescribe the form of VAT invoice and the minimum information to be included for invoices to be considered VAT-compliant. Again, it is anticipated that this information will be provided in the Executive Regulations.

Record-keeping is also important. Certain tax-related information will need to be retained for a specified period – anticipated to be for a period of at least five years. The VAT Law again provides general guidelines on this, to be supplemented by the Executive Regulations. Importantly, whilst a VRB may compile such information in any language, its tax returns must be submitted in Arabic (translated at their own cost).

At present, it is anticipated that tax returns must be filed on a quarterly basis through a government portal (to be confirmed by the Executive Regulations). It is likely that tax returns will be required to be broken down in such a way as to reflect input tax and output tax per Emirate, subject to the provisions of the pending Executive Regulations.

Business costs

VRBs should consider in general how business operations costs might be impacted by the introduction of VAT – for example, as a result of the cost of accounting system upgrades, training accounts staff, general training for all employees, or an increase in general operational costs (such as insurance) that will or are likely to attract VAT. VRBs should also consider how the business is going to be able to manage, absorb or pass-on those additional costs.

Cash-flow risk assessment

The general requirement to account for VAT will be on an accrual, rather than cash, accounting basis. Subject to certain exceptions, that means the tax point will be when an invoice is raised, unless goods are supplied, services are completed or payment for these is made prior to the rendering of the invoice.

This means a VRB may be required to account for VAT to the FTA before it has been paid by its clients. VAT accrual will therefore have to be carefully managed to maintain sufficient cash-flow to protect a VRB's liquidity.

Review of existing and new contracts

VRBs should be in the process of re-visiting contracts for on-going projects which cross the 2017 year-end into 2018.

The general rule is that, for goods or services invoiced before 1 January 2018, the date of supply for VAT purposes becomes 1 January 2018 where:

- Such goods or services are transferred or placed at the recipient's disposal
- Assembly/installation is completed
- A customs declaration is issued
- The recipient accepts the supply, in each case after 1 January 2018.

There are exceptions to the general rule. Special provisions are expected to be included in the Executive Regulations for contracts concluded before 1 January 2018 where the supply under a contract is made wholly or partially after 1 January 2018.

What is currently clear, however, is that where a contract executed before 1 January 2018 is for a taxable supply to be made wholly or partially after 1 January 2018 and does not provide for VAT to be levied, the consideration for the goods or services shall be deemed inclusive of VAT. In essence, under the current provisions the supplier bears the cost of VAT. However we anticipate provisions in the Executive Regulations that may allow the supplier in certain circumstances to recover the cost of the VAT where the customer has been able to recover those costs itself.

It is therefore better to adopt a 'best practice' approach by addressing VAT now by contract amendment if necessary, to be signed by both parties prior to 1 January 2018. This will allow a VRB to implement the 5% VAT charge on top of pre-agreed charges for the taxable supply of good or services with effect from 1 January 2018.

Standard form contracts and clauses should also be amended to account for VAT. Some contracts provide for price adjustment for changes of law, but our recommendation is to address VAT expressly in your contract to avoid any ambiguity.

Transitional period

These are just some of the practicalities that businesses will need to consider. We shall write further on this topic and how it may affect your industry sector as and when further information becomes available. For further information and practical advice on the impending introduction of VAT in the UAE you can contact the authors of this briefing.

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