

## Value Added Tax (VAT) in UAE – Key Implications?

Implementation of any new legislation is expected to bring forth challenges for businesses to understand the complexities of the law thereby the need to amend the existing methodologies, systems and procedures to comply with the legislative requirements. As we know, VAT has been introduced in UAE with effect from 01 January 2018 and the interim period has given businesses the opportunity to understand the practical issues involved and streamline in the light of new regulations. As of now, FTA's call center has addressed around 170,000 queries and concerns of the business. It has been stated that approx. 275,000 businesses have registered under VAT and VAT implementation in UAE has seen 98.8% compliance with Tax return regulations.

With this background, we have identified areas worth consideration to highlight key observations post first quarter of VAT implementation.

- **Impact on Business and its quantification** –VAT could have broadly two implications for a business, either it could impact the working capital wherein the tax due is paid to the authorities before received from the customer hence negatively impacting the same. In other scenario (typically where there are supplies which are exempt in nature or tax paid on cost which couldn't be claimed as input tax (especially, the input tax paid on purchase of motor vehicles, employee related expenses, etc) results into VAT paid getting converted to a tax cost (as against pass through cost). It is critical for the businesses to evaluate the impact of this change on the working capital and / or the profitability in the MIS reports to possibly enforce corrective measures to control the situation
- **Role / responsibility as a customer – Is your Vendor is charging VAT** – Apart from the contents of the invoice which needs to be in line with the legislation, it becomes critical to ascertain /check if your vendor is registered or not. While the liability to register is that of the vendor provided he meets the thresholds, but it is also important that our transaction value with an unregistered vendor is monitored to ensure that the same is not breached.
- **Whether the Systems are geared up** – The VAT return (form for compliance / filing) is to be filed at end of every tax period. In the world of ERPs one need to have a sanity check done with respect to the output and ability of the system to generate the required content / data in the desired categorization for the purpose of filing the return. Considering the fact that there could be post filing audit enquiries from the authorities, it becomes increasingly critical to keep a audit trail and reconciliation of the tax return data and the data and reports for the purposes of accounting. The controls incorporated in the system gives an added insulation on any unwarranted errors from the time of recording to the time of reporting. However, in case of errors/omission the consequences could be serious.

In addition to the above areas, we have captured few observations of common scenarios faced by businesses under UAE VAT and possible way forward on the same following paragraphs.

- **VAT applicability on allocation of common cost / recharges-**

In a typical scenario prevalent in group companies, Company A will incur expenses on behalf of Company B and payment against such expenses will be made by Company B to Company A in the form of recharge/ reimbursement/sharing of common costs. This is merely an on-account payment made by one entity on behalf of other entity (acting as an agent for the other entity). The UAE VAT regulations, however, don't recognize the concept of "pure agent" and hence this transaction would also be construed as a "provision/supply of service" and thereby trigger VAT.

However, the same will need to be evaluated by the businesses based on the nature of expenses recharged and taxability of underlying supply involved in the transaction under consideration.

- **Availability of credit on input tax paid in case of expenses incurred by employees on behalf of the company-**

Input tax is recoverable by a taxable person as long as the same is used or intended to be used for making taxable supplies or other specified supplies outlined in the VAT Legislation<sup>1</sup>. However, businesses will need to evaluate whether input tax will be recoverable in case where the expense has been incurred by the employee in their own name, though indirectly pertains to the taxable supplies made by the company. For example- whether input tax will be recoverable in case of expenses incurred for meetings done by the employee for the purposes of business development.

- **Supply of goods other than for manufacture within Designated Zones-**

Supply of goods from a Designated Zone to another Designated Zone are not considered as supply within the state unless the goods are used or altered during the transfer between the Designated Zones. Given the above, supply of goods within Designated Zone for consumption will be taxable at 5%. For example- in case a chemical is sold by Company A which is consumed by B in the manufacturing process, then VAT will be applicable on the transaction.

However, in such scenario the supplier will be required to have knowledge of end use of the goods by the customer which creates a practical challenge. Considering the same, appropriate documentation needs to be obtained and maintained by the supplier at the time of making supply within designated zone in order to determine the taxability of the transaction.

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<sup>1</sup> Cabinet Decision No. (52) of 2017 on the Executive Regulations and Federal Decree-Law No (8) of 2017 on Value Added Tax are jointly referred to as VAT Legislation in the entire article

- **Exchange rate in case where invoice is in currency other than UAE Dirham-**

In case where supply is made in a currency other than UAE Dirham, the amount stated in the Tax invoice is required to be converted into UAE Dirham according to the exchange rate approved by the Central Bank at the date of supply. However, as on date, the Central Bank has not notified exchange rates to be considered for conversion of invoice to UAE Dirham. However, considering the interim situation (until the notification wrt the rates is issued by Central Bank or other clarification is provided by the FTA) a consistent recognized platform providing exchange rates could be adopted for the purposes.

#### **Concluding remarks-**

Since VAT is a new tax –it requires significant steps to be blended in the upgraded way of how businesses function. Businesses need to ensure complete, accurate and timely reporting in order to avoid unpleasant instances of penalties or even audit queries which could be challenging to tackle.

Additional steps need to be taken to ensure that any operational/ business challenges are appropriately identified and adequately mitigated. Attention must be given to understand the treatment of deemed supplies, goods or services used by company's employees, taxability of recharges, treatment of supplies within designated zones, intra- GCC supplies, exchange rate in case of supply in another currency, treatment of discounts, imports, required amendments to contracts, etc. to ensure that the business operations are not adversely impacted owing to introduction of VAT.

The UAE Federal Tax Authority (FTA) has been constantly working to support the businesses in the time of transition and sharing tax guides periodically to address any open points or challenges faced in particular industry. Given this, businesses need to identify and resolve the interpretation issues by obtaining legal opinion of issues faced. Also, appropriate training needs to be delivered to employees in order to help them understand and cope with the issues presented by the VAT levy introduced.

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