VAT
One year and beyond

Foreword

The year of 2018 has been a remarkable milestone for the United Arab Emirates ('UAE') with the introduction of Value-Added Tax ('VAT') that took effect from 1 January. It has been roughly a year since go live, during which businesses and tax authorities alike have been managing this important transformation and transition. This is a good time to assess any remaining challenges and explore ways to optimise efficiencies and further mitigate risks. This is even more relevant as businesses are faced with a constantly evolving regulatory environment.

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Implementation challenges

VAT has an impact on the organisation overall and in order to be managed affectively, it requires a strong understanding of the rules and solid internal processes and controls across the various business units, including finance teams, legal, IT, and marketing. This was a common theme during the implementation phase that required businesses to make critical changes to their systems and operations.

The decision making process was sometimes delayed by a number of businesses as they were expecting absolute certainty around the regulations. The UAE VAT Executive regulations were released 5 weeks prior to the implementation date, and although some businesses started preparing before the rules were released by making educated and informed decisions based on international practice, some businesses waited for certainty, and this had an impact on their readiness by go live date.

Businesses in general faced common challenges, ranging from familiarising with new and unique concepts, meeting the documentary requirements, and deciding on the VAT treatment of a large number of specific transactions and schemes. This was even more critical for some industries that have complex transactions (e.g. financial sector, real estate) and some of the issues raised were addressed by clarifications issued by the Federal Tax Authority (FTA), while some remaining areas need to be clarified.

Systems and technology

One area of complexity for businesses was to get their systems VAT ready. With the implementation of VAT, companies are required to ensure that all business and IT processes are adapted to comply with the VAT requirements as any potential non-compliance with the law/regulations may lead to administrative or tax penalties, financial exposure, reputational damage, etc. The sheer complexity of some businesses' system landscape has led in some instances to the initial full-fledged plan being replaced by an alternative 'quick fix' solution in order to ensure the filing deadline of the first return is met. It is critical to get this right and businesses need to rethink how they can use technology to optimise their compliance and mitigate any risks.

Refund positions

Based on our experience, we have observed that the majority of VAT registered businesses in refund positions requesting a cash refund have been subject to additional queries by the FTA requiring in some instances a large volume of information to be provided within a relatively tight timeframe. We understand that a number of taxpayers have received refunds to date and the average claims process is currently taking 2-3 months subject to the requested information being provided within specified timeframe.

Partial input tax recovery

Unlike the standard output tax apportionment method ordinarily adopted by most VAT jurisdictions, the input-based method of apportionment dictated by the UAE VAT legislation has placed strains on businesses notably the financial services industry. This has resulted in significantly different outcomes and the recovery rates applied to VAT incurred on mixed expenses may range from a mere 0% to a whopping 100%.

The Government's proactive approach

The FTA adopted a proactive approach in helping to address some of the issues faced by businesses including in relation to specific industries. The FTA has provided guidance by engaging through public awareness sessions, making use of social media and gradually issuing a series of notifications, public clarifications, press releases and guides. The FTA has also organised meetings with key stakeholders and representatives of the specific sectors to identify and address concerns. It is anticipated that the clarifications will be updated regularly, and a constant stream of rulings and taxpayer guidance will be issued by the FTA. Of the latter the financial services guide is most eagerly awaited and it is anticipated that this guide will be issued soon.

Clarifications issued by the FTA

Use of exchange rates for VAT purposes

The application of exchange rates was a very contentious issue across the business sectors which may had to be addressed sooner. Ultimately, the Public Clarification VATP004 was issued in July 2018 clarifying that the UAE Central Bank started publishing exchange rates from 17 May 2018 onwards and requiring businesses to use the published exchange rates to calculate the corresponding AED amount for transactions made in foreign currencies. This Public Clarification also provided guidance on the exchange rate issue during the transitional period from 1 January 2018 to 16 May 2018.

Tax invoices

The FTA released Decision No 2 of 2018 on 20 March 2018 which allowed for some leniency towards documentary requirements with respect to the issuance of tax invoices by financial institutions that hold a banking license issued by a competent UAE authority. The Decision addressed tax invoices and tax credit notes issued for the supply of services to recipients (e.g. retail customers) who are not registered for VAT in the UAE, removing the requirement to issue said documents until 31 December 2018. Furthermore, Decision No. 2 also temporarily removed the requirement to include the tax registration number of the recipient on tax invoices and tax credit notes in the event the said documents are issued to recipients which are VAT registered in UAE. This final concession was valid until 30 June 2018.

Public transport

The FTA issued VATP007 – Public Transportation on 1 November 2018 which provides clarity on the zero rating provision for the supply of means of transport under Article 34(3) of the UAE VAT Executive Regulations, i.e. a supply of bus or train that is designed or adapted to be used for public transportation of 10 or more passengers. The clarification addresses the definition of ‘public transportation’ and its interpretation for the purposes of identifying the means of transport which qualify to be supplied at the zero rate. The interpretation clarifies that the zero rating applies to the supply of buses or trains which are designed or adapted for the transport of individuals without being restricted to a specific category of users.

Insurance

The FTA released VATGIN1 – Insurance Guide on 2 October 2018 which touches on the characteristics of insurance and related services for VAT purposes. In addition, it provides guidance for the insurance industry to understand which of the services and functions it provides are liable to VAT and which are exempt from VAT and in turn, the extent that VAT recovery on costs is possible. Noteworthy, is that where an employer provides health insurance to the family of the employee, input tax will only be recoverable if there is a legal obligation to provide the insurance to the family members.

The road ahead

The year 2018 has certainly been eventful and the VAT road ahead will still require additional clarity on certain topics and further efforts to achieve an effective transformation as we get into business as usual mode. The recommended approach for businesses is to always be proactive and play an active part in the design and implementation of the system and ensure full compliance with the requirements. Based on our experience over the last year, here are some of the key topics that will most likely impact your business in the coming period.

Intra Gulf Cooperation Council ('GCC') supplies

The treatment of intra-GCC supplies is certainly a topic that caused confusion initially not only from a technical application perspective, but also to understand the government's position given not all GCC States implemented VAT on 1 January 2018. In addition, the VAT system implemented in each GCC States (UAE and Kingdom of Saudi Arabia (KSA) comprises some variations including with regards to the treatment of some specific sectors.

Initially, when the UAE and KSA stated that it would not recognise each other as VAT Implementing States. This has led some businesses to revisit their initial transaction coding and system changes to reflect these decisions. This included changing the treatment of supplies made to registered recipients in other GCC implementing States to supplies in scope for VAT purposes and ensuring that intra-GCC transaction documentation requirements are not activated in the transition period.

At this stage it is unclear when the corresponding GCC governments' will recognise each other as Implementing States pursuant to its respective VAT legislation. However, it is crucial that businesses remain wary of the impact this will have and should be ready to adapt their system as required given the potential notice period could be very short.

Partial input tax recovery

The FTA has stated that it would be open to consider applications for alternative methods of apportionment from 1 January 2019 onwards. It should be noted that from our experience in other jurisdictions applying for alternative methods of apportionment could take months. The process is not only dependent on the tax authority having to consider taxpayers' applications (which in itself is likely to be an extensive exercise in a newly implemented VAT jurisdiction as industry comparisons and research would be required), but also on the initial investigation by the taxpayers themselves in order to ensure the most fair and reasonable apportionment methodology is applied for. Therefore, it would be prudent to submit such applications to the FTA well in advance of the next tax year.

The Government's proactive approach

The FTA has introduced a process whereby a person may request clarification in the form of written guidance or advice about the FTA's interpretation and position on specific tax matters of uncertainty. This process requires the taxable person to submit, among others, a Clarifications Form (available on the FTA's website) to clarifications@tax.gov.ae. Noteworthy, is that it may take the FTA up to 40 business days to respond to a clarification request.

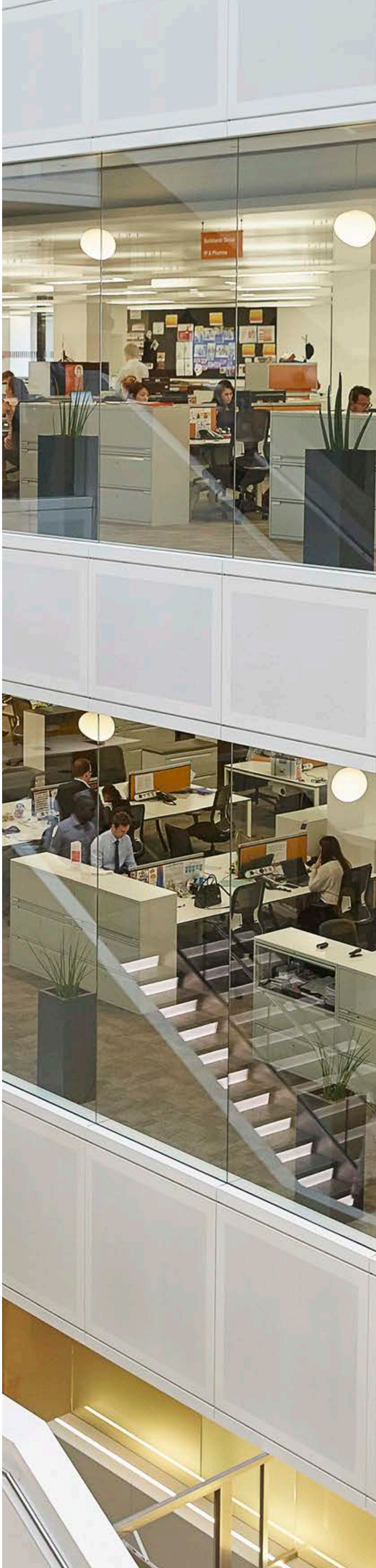
Administration

Compliance is a key focus for tax authorities and as the FTA further strengthens its capabilities, we can expect the FTA to continue issuing clarifications on some key topics to provide more certainty to taxable businesses. We may also see in the coming period an increase in audits/verifications from the FTA not only for businesses claiming a refund, but more generally to ensure compliance with the legislative requirements. As the FTA expands its team, thereby simultaneously maximising efficiencies, we can expect the processing of clarification and refund requests to become much smoother in the coming period.

Given the aforementioned it is a taxpayer's responsibility to keep up to date with the latest legislative changes and guidance published by the FTA and be aware of the mechanisms which have been put in place to assist taxpayers. Two such mechanisms are the voluntary disclosure and the reconsideration processes. Should taxpayers become aware of previously undisclosed errors or omissions, it is always best practice to refer to the relevant legislation and the Voluntary Disclosure Guide to ensure the issue is dealt with effectively to minimise the risk of penalties. The second mechanism at the disposal of taxpayers is the reconsideration process whereby taxpayers can request a reconsideration of any decision taken by the FTA. Noteworthy, is that reconsideration requests will currently only be accepted in Arabic.

Conclusion

The implementation of VAT is not the end, but just the beginning. There will be learnings along the way and the VAT journey which the financial services industry in the UAE is embarking upon should be seen as a permanent feature in the organisation, not as a 'quick fix' short term project.



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