New Tax Regime in GCC Countries

Value Added Tax (VAT) is set to make its debut in the six-nation GCC block on 1st January, 2018. VAT is basically an indirect tax. Occasionally you might also see it referred to as a type of general consumption tax. In a country which has a VAT, it is imposed on most supplies of goods and services that are bought and sold. Over 150 countries have implemented VAT (or its equivalent, Goods and Services Tax), including all 29 European Union (EU) members, Canada, New Zealand, Australia, Singapore and Malaysia to name few. VAT is charged at each step of the 'supply chain'. Ultimate consumers generally bear the VAT cost while businesses collect and account for the tax, in a way acting as a tax collector on behalf of the Government.

GCC Countries are introducing VAT as it will provide their country a new source of income which will contribute to the continued provision of high quality public services into the future. The United Arab Emirates ("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. The UAE will remain tax-free in many ways even after the implementation of VAT as there is no income tax on salaries in the country. Free zones in the country also offers tax free environment including 100 per cent foreign ownership in free zones, ease of doing business, etc. The Government is likely to use its ability to either zero-rate or exempt many supplies, to ensure that the impact of VAT is kept to a minimum. Electronics, smartphones, cars, jewellery, watches, restaurants and entertainment will fall under the taxed category. Some categories of supply which are exempt from tax are supply of specific financial services (to be explained in tax legislation), residential real estate, space/free space, local transportation of passengers etc.

It is estimated that the UAE will generate more than Dh 12 billion additional revenues in the first year after implementation of VAT and around Dh 20 billion additional revenue at the end of second year. GCC countries have decided to implement taxation as part of the Governments' efforts to diversify revenues in the context of sharp decline in oil prices. The International Monetary Fund has been recommending fiscal consolidation in the GCC through diversification of government revenues and reduction of subsidies.

The average VAT rate in the world is 15 per cent and it goes as high as 27 per cent in Hungary, amongst the OECD nations. Multinational and foreign companies operating in UAE will prefer to pay low consumption tax here and avoid higher charges in their home country as the same tax cannot be levied twice as per international law. The UAE has signed more than 103 agreements on the avoidance of double taxation, and more than 66 agreements to protect and promote investment with various countries. These deals provide a legal framework allowing tax authorities to cooperate without violating the sovereignty of other countries or the rights of tax payers. Thus, introduction of VAT is the right step towards broadening the tax base without imposing corporate or personal income taxes.

The businesses shall register for VAT if its taxable imports and imports from abroad exceed the mandatory registration limit of AED 3,75,000. In addition, businesses can register for VAT optionally if their taxable imports and imports from abroad are less than the mandatory registration threshold, wherein the optional registration limit exceeds AED 1,87,500. Non-residents that make taxable supplies in the UAE will be required to register for VAT unless there is any other UAE resident person who is responsible for accounting for VAT on these supplies. Businesses will be required to keep records which will enable the Federal Tax Authority ("FTA") to identify the details of the business activities and review transactions. The specifics regarding the documents which will be required and the time period for keeping them will be stated in the VAT legislation. Any taxable person must retain VAT invoices issued and received for a minimum of 5 years. Taxpayers must file VAT returns with the FTA on a regular basis (quarterly or for a shorter period, should the FTA decide so) within 28 days from the end of the tax period in accordance with the procedures specified in the VAT legislation.

It is also expected that there will be specific rules dealing with the VAT treatment of supplies of goods and services from a supplier in one GCC country to a customer in another GCC country since each GCC country is going to come up with different national legislations. These rules may also differentiate when these supplies are made to VAT registered persons or otherwise. For example, the supply of goods by a VAT registered business in one GCC country to a VAT registered customer in another GCC country would require the customer to self-account for VAT upon acquisition of goods (as opposed to the supplier accounting for VAT upon sale). Detailed recording and reporting of these intra GCC supplies will be required and this will likely require more administration and resources to ensure compliance. Businesses involved in cross border supplies in GCC countries need to consider these additional requirements when planning for VAT implementation.

The UAE Ministry of Finance is yet to take decision for VAT for businesses in Free Zone; however, these Free Zones may remain exempt to encourage foreign investments.

For many number of years, the GCC countries especially UAE was considered as investment vehicles by various MNCs because of the tax haven status and absence of various taxes. Now with the proposed introduction of VAT, there is a line of thought that it could affect the investments from foreign countries adversely. However, considering the fact that the rate of tax would be 5% flat and additionally, the exemption available to various essential commodities, it is expected that there would not be a huge impact with respect to such foreign investments. Considering the rate being as low as 5%, it is a win-win situation since the Government would be able to garner additional revenues without affecting the consumers in a great manner.