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THE EFFECT OF TWO YEARS OF VALUE ADDED TAX IN THE UAE

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Abstract

The economic stability of every country relies on its funding sources, whereby the country maximizes on trade, exploration and other funding avenues. In most cases, imposing taxes on its citizens and other trade deals ensures sufficient supply of funds especially when the country has extensive budgets. Therefore, tax imposed differs from one country to another depending on public amenities being funded by taxed money. These amenities include infrastructure, health care, education, and military service among others. However, there are countries or regions that do not require taxation such as the United Arab Emirates, which generated most of its income from oil sales, hydrocarbons, and tourism. It sustained the region's growth over the years, shielding its citizens and foreigners from federal income tax. The directive changed on 1 January 2018 when the government imposed a five percent VAT. The research paper will focus on UAE's history, the reason behind the VAT rule and its effect on revenues, trade, and tourism.

Keywords: VAT, effect of VAT, inflation, UAE

INTRODUCTION

Value-added tax, VAT, refers to tax imposed on consumer goods or services and levied from each point of sale (Conn & Prabhu, 2019). Therefore, the end consumer bears the cost after businesses collect the amount from their purchases. The businesses act as intermediaries of the government, taking the tax on behalf of them. In consumer goods, the government taxes the suppliers then tax the producers before taxing the consumer. The process seems complicated as detailed in the example, but in most cases, the VAT is part of the product's final price. Therefore, there are no hidden charges during purchases. Another form of tax is excise tax, which refers to a levy imposed on manufacturers and not the customer (Conn & Prabhu, 2019). It comes in the form of customs duties, especially where one needs to import a product. The main difference between VAT and excise tax is that excise tax is on specific goods, mostly those that the government deem as bad for the society such as alcohol and tobacco among others.

In UAE's case, Federal Tax Authority commenced the publication of various public clarifications on Federal Decree-Law No. (8) of 2017 (Zafarullah, 2018). The publications offered clarification on VAT-related matters such as profit margin scheme on eligible goods, exchange rates, and compensation-type payments. In addition, FTA published user guidelines on VAT refunds, voluntary disclosure, and clarifications. Since the introduction of VAT, the FTA continues to make great strides in ensuring compliance in the industry (Zafarullah, 2018). Being a new law in the country, the FTA needs to ensure transparency and compliance from businesses. The taxation system integrated new input tax apportionment for various businesses that incorporate exempt and taxable supplies. The taxable bracket includes insurance companies, financial services, real estate business, and local transport providers. FTA borrowed a leaf from most VAT systems applied globally, making it possible to issue tax returns. Over the past two years, FTA came up with guidelines that enable fair results across various sectors.

Defining zero-rated and VAT-exempt sectors by FTA provides guidelines on businesses not affected by the directive. Most of the zero-rated sectors touch on international trade, whereby FTA chooses to exempt them from the five percent VAT tax (Conn & Prabhu, 2019). They include export of services and goods outside the GCC, and international supplies and transportation, supplies to certain air, sea and land transportation means, and certain precious metals such as silver and gold. Goods pertaining to education and health services are under the bracket as they provide basic elements in the society. FTA categorized different suppliers under the VAT-exempt sectors such as residential properties, bare land, local passenger transport, and financial services (Conn & Prabhu, 2019). In regards to a partial exemption, businesses have to use input tax as a basis for apportionment though there will be other methods that provide fair terms under FTA. The partial exemption will be a critical docket for FTA as information gathered needs to illustrate whether an individual or business will be taxable or not.

VAT ENFORCEMENT AND RULES

The law put in place by FTA creates a standard apportionment based on the ratio of attributable input tax to taxable supplies on both exempt and taxable supplies. For example, 50 percent of attributable input tax businesses incur recounts as taxable supplies, whereby businesses can deduct an overhead of 50 percent on attributed input tax (Zafarullah, 2018). With the new rules in place, FTA instilled special methods that it can use as an alternative to their current method of apportionment. The first one, outputs-based method, offered to Islamic and non-Islamic banks, insurance companies and local transport service providers (Zafarullah, 2018). The second one, transaction count method, offered to Islamic and non-Islamic banks that engage in investment and wholesale trading activities. The third one, floor space method, offered to businesses in residential and commercial real estate leasing and sale business. Lastly, the sectorial method offered to complex businesses that conduct their trade activities in different divisions and are independent of each other based on accounting and operations.

FTA offered the special method for a period of two years and applicants cannot apply for a change in approved special method beyond the timeframe. Moreover, FTA's guidance helps some of the businesses affected by the apportion input tax to sort out their queries and differences (Conn & Prabhu, 2019). The proposals for special methods seem inflexible and cannot be practical if instilled in some situations. FTA has a long way to go in regards to defining business sectors affected by the respective laws. One area of concern by businesses is tax refunds, especially for foreign businesses. FTA addressed the trepidations by announcing non-established foreign businesses can post their claims with the agency for VAT incurred in the year 2018 (Saderuddin & Barghathi, 2018). Such directives demonstrate FTA's commitment n redefining VAT in the UAE and sort out future claims while providing guidance to businesses. As FTA guides UAE in instilling VAT on businesses, the five percent tax has a ripple effect on the economy with each sector having different changes.

VAT EFFECT ON ECONOMY

Inflation is the initial effect of VAT in UAE, as businesses have to adjust their prices in a bid to remain profitable. In January 2019, inflation increased by 4.8 percent surpassing the 2015 limit. However, it gradually dropped to 3.4 percent in March (Nagraj, 2018). Based on the inflation changes, the VAT's impact might seize in future as the economy adjusts and stabilizes. The real estate market in Dubai and Abu Dhabi slumped, pushing companies to pull down on their residential rents weighted heavily by consumer price indexes. FTA's guidelines on VAT charges in real estate help define market changes and differentiate tax on commercial and residential estates (Nagraj, 2018). Supplies for commercial properties are under the tax bracket while supplies for residential properties are not. The directive ensures VAT does not constitute as part of irrecoverable cost on those set to buy properties. However, the differences might have a ripple effect on construction and prices of commercial buildings.

According to a recent report by PwC Middle East Economy Watch, inflationary impact in UAE and Saudi Arabia is under control as it helped the countries surpass the projected revenue budget (Nagraj, 2018). The tax policy proves to be efficient in diversifying government revenue and cause little inflation in the economy. By December 2018, VAT helped the country to raise $12.2 billion, which is a third of their expected returns and accounts for 1.6 percent of the country's GDP (Nagraj, 2018). Economic stability in the country allows the government to budget for new developments and ease its burden on overdependence on oil. The increase in oil prices in the year 2018 helped the government gain higher returns, equally increasing its VAT collection. However, the sudden surge in prices at the end of 2018 might affect its tax collection and their annual targets. In spite of the uneven prices, VAT proves to be sentimental in providing the nation with an alternative source of income.

Apart from inflation in the market, VAT affected other sectors immensely during the two-year period. Consumer prices had a significant surge as the effect of VAT on consumer goods from suppliers to sellers came into effect (Conn & Prabhu, 2019). Based on market research, most of the products increased their prices by 10 to 15 percent. The purchasing manager indices (PMIs) in UAE slumped to the lowest record level by December and declined further by 54.8 percent in March (Conn & Prabhu, 2019). These changes affect other sectors such as tourism, where the tourist will avoid overspending. FTA set guidelines that exempt tourists from taxation and can receive tax returns for goods taxed. However, it is not a streamline process and most tourists do not want to risk not getting their cash back after purchasing the items. In the end, the economy will suffer immensely from a drop in sales especially by tourists unless the government, through FTA, reviews their guidelines.

Transitioning into the VAT system affected most of the businesses, as they have to restructure their organizations to cater to the changes. In the high-value sector, the VAT deems crucial to the industry as the demand for working capital increased abruptly (Nagraj, 2018). In addition, the lack of experience with federal tax regimes makes most of the businesses unsure about the procedures required to be compliant. Another problem that faced the sector is voluntary or delayed registration processes that can cause losses to the businesses. Transitional transactions stood out as the key dispute areas for businesses with the VAT rules providing little relief from commercial challenges businesses faced in the initial stages (Nagraj, 2018). In the real estate sector, the application of zero-ratings or exemptions for residential properties and bare land in UAE can be complex for businesses. Without proper guidelines and assistance from FTA, most businesses find it hard adjusting to the new system with delays that span several months before their operations return to normalcy.

Issues faced in UAE after the VAT rule resonates with other markets, especially during change phases. Companies and businesses have a hard time adjusting to new measures as they can be challenging at first. In most cases, the lack of skilled personnel to guide businesses through the transition makes it hard for them to adjust to the changes. In UAE's case, confusion around clarification and scope challenged most business sectors, as they had to understand the law and clarify their tax sector. As discussed earlier, the VAT rules exempt visitors from taxation and any taxable items purchased in the country entitles them to a refund. However, the sector lacks proper guidelines, pushing away tourists from making purchases. Other issues in the taxation system will make it hard for the country to forge the correct path forward in terms of taxation. The need to bring in experts to guide FTA and the general public will go a long way in ensuring compliance.

FTA's commitment to improving the VAT rules influenced the Cabinet of Ministers Resolution n. 31/2019, where they focused on Regulations for Economic Substance, ES (Deloitte, 2019). The rules marked a major milestone for UAE's tax policy to businesses and companies in the country. In addition, it marked an important step in the alignment of global Base Erosion and Profit Shifting (BEPS) and Organization for Economic Co-operation and Developments (OECD) directives (Deloitte, 2019). The rules brought specific requirements for businesses to illustrate their actual economic activity within the country. Moreover, the rules cleared the misconception that UAE does not seek any benefits from the tax regime. The ES rules in UAE are similar to regulations observed in other countries with similar tax environment. In essence, the economic substance test focuses on three main pillars that businesses have to abide with. These directives ensure that the company's core business, revenue, and staff work within the region and in cases where the company operates in other nations the ES rules will redefine their tax sector.

From the discussion, the introduction of VAT helps UAE to expound on its GDP and gradually integrate it as a revenue resource. Over the decades, the region relied heavily on oil and in recent decades, tourism became a big sector in the region. However, its overreliance might have a ripple effect on the country's economic future and stability, prompting the government to enact 5 percent VAT. The directive continues to cause ripples in the market as businesses and companies abide by the law. FTA undertakes its mandate as the tax regulator promptly and integrates changes that clear any disputes brought forth. The continued effort by business and companies in complying with the directive enabled the region not to suffer immensely in terms of inflation. With time, the nation will build a strong economy using its various revenues.

CONCLUSION

In conclusion, the VAT regime in the UAE presents mixed reactions and effects in the market as companies and businesses work towards compliance. Inflation stands out as one of the major effects of the VAT regime though various analysts predicted it. Moreover, the cost of doing business in the region increased significantly, but it will gradually normalize with time. The past two years proved to be challenging to the government and businesses due to the changing economic times though they brought about great progress in the region.

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