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Value Added Tax in UAE: what we know so far

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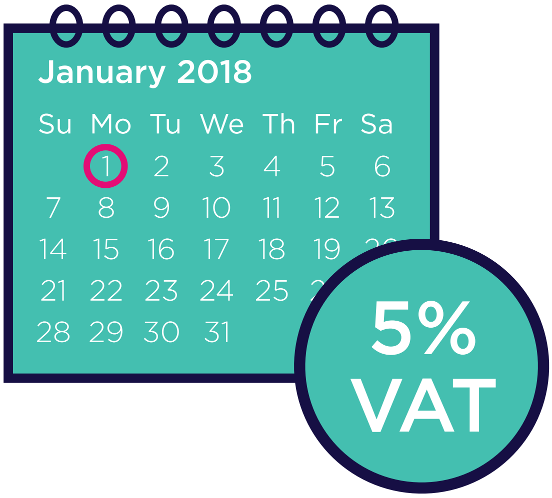
With the clock ticking before the introduction of value added tax (VAT) in the United Arab Emirates on 1 January 2018, and a goods and services tax (GST) that came into effect in India on 1 July 2017, it is little wonder these consumption taxes have become a major talking point for businesses throughout the region.

How the implementation of VAT will affect certain industries is currently unclear. In this report we look at how VAT has been introduced in other markets and offer considerations for VAT readiness.

The UAE will implement VAT at 5% at the start of next year. Some items will be exempt from VAT or zero-rated, including investment-grade gold that contains at least 99% purity. The decision on VAT was reached over a year ago following talks between the GCC and the International Monetary Fund.

His Highness Sheikh Hamdan Bin Rashid Al Maktoum, Deputy Ruler of Dubai and UAE Minister of Finance announced in August 2017 that VAT at 5% would be implemented across all Gulf Cooperation Council (GCC) countries over the next two years and in the UAE from January 2018. He said the tax would bring in "a new revenue for the national economy and GDP".

This, in turn, will ensure "consistency in the high quality of government services, to mirror the UAE's advanced position on several global competitiveness indexes," he said.



Value Added Tax will be introduced in the **United Arab Emirates** on **1 January 2018** at a **rate of 5%**

The supply or import of investment precious metals such as gold, silver and platinum, to the purity of 990 thousandth or more, will be zero rated, as will all goods and services exported outside the GCC.

VAT at 5% is viewed as relatively low compared to OECD (Organisation for Economic Cooperation and Development) countries such as the UK where the rate is 20%. The consensus among experts is that the modest VAT rate proposed by GCC means minimal impact on trade, business and consumption.

Following the introduction of GST at 10% in Australia towards the end of the last millennium, a KPMG report recorded the rate was viewed as "low" and as GST replaced less efficient taxes, the effect was "enhancements to living standards in Australia", according to KPMG.

In Dubai, VAT will not replace other taxes - unlike GST in India. It's a new tax to be levied in a country where consumption taxes have been absent hitherto. Looking back to when GST was introduced in Australia in 1999, politicians and media warned of dire consequences. There were stories it would ramp up inflation, encourage businesses to operate in the cash economy, send the economy into recession, depress living standards and lead to bankruptcies.

But three years after its implementation, the Australian Treasury Office conducted a comprehensive analysis of GST and found "these predictions do not appear to have been realised".

Tony Dobra, CEO of London gold bullion trader Baird & Co said "the key to efficient taxation was to keep rates low and the system simple." He believed the effect on the jewellery and gold business in Dubai would be manageable as VAT was being introduced at a low rate.

"It's the bureaucracy that is going to be the issue. I spend about 40% of my time on things like VAT, payroll tax and so on. It has a management cost to it."

There was an even more positive note from Mark Williams, chief Asia economist at Capital Economics. He said governments have to bring in income and while the UAE still enjoys one of the highest living standards in the world, the introduction of VAT will continue to drive welfare, education and health services to citizens.

He said: "You can have a cyclical hit to demand, but then often people get used to VAT, and there is a bounce back in the medium term as long as core supply and demand are favourably balanced."

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He added: “Usually when these things are introduced one new tax replaces one old tax. But generally, governments try to make new taxes fiscally neutral when they introduce them. They have different tax rates on different products and they will start out with them quite low in many cases.”

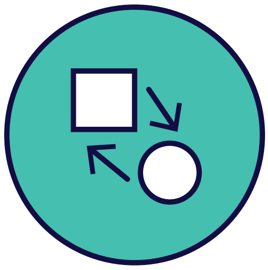
Dubai businesses seeking support

Terri Bruce, a tax adviser at British-based accountancy firm Moore Stephens said Dubai businesses were now actively seeking help and support in preparing for the implementation of VAT. She has been in the UAE, Oman and Qatar and found that people are “becoming more interested in VAT, and the impact it will have on their business”.

Bruce expects VAT in the GCC to operate in very much the same way it does in the EU. In other words, directives give a framework within which to work. Then, each member state implements its own legislation that incorporates details that fit in the overall framework.

A recent report from the Arab-British Chamber of Commerce, authored by Moore Stephens’ Robert Noye-Allen, said preparation by business was vital. He said questions should be asked such as “what the effect would be on employees”, and an assessment should be made on “whether they had the capacity, capability and training that was necessary to absorb the impact of the introduction on VAT”.

A recent Deloitte survey that looked at Dubai as well as re-visiting the introduction of GST in Malaysia at 6% in 2015, made a number of points. The survey found 43% of respondents in Dubai believed the introduction of VAT would adversely affect the competitiveness of GCC states, and the same proportion believed



As a consumption tax, **VAT is charged on majority of transactions** of goods and services

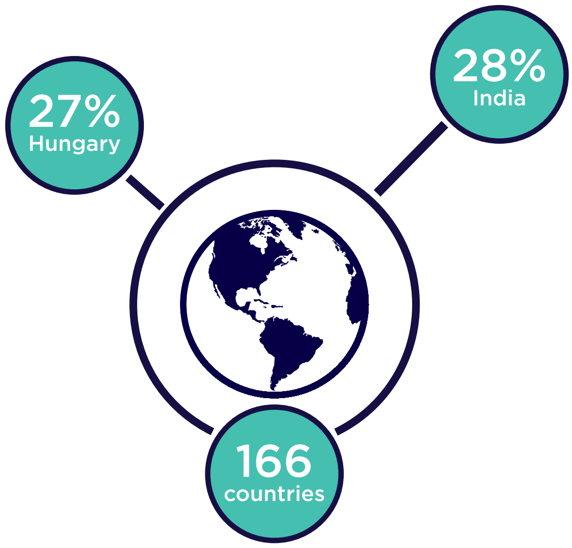
VAT registered **businesses may reclaim the VAT** paid on business related goods and services

VAT is **charged at each stage in the supply** of taxable goods and services

VAT is ultimately **borne by the final consumer** the annual cost to their business of being VAT registered could be between $25,000 and $100,000.

Clearly, firms will be impacted financially by the introduction of VAT - by the work involved in updating their business operations in order to be VAT-compliant, particularly in sectors where VAT may be wholly or partially recoverable. Over half of respondents in the Deloitte survey felt VAT would have a negative impact on their business. The vast majority of this group feared VAT would dent the profit margin of their business as they wouldn't be able to increase their prices "in an already more than competitive market or because they think that a price increase will have a negative impact on the demand for products as a whole", said Deloitte.

One finding from Malaysia was that many businesses in that country under-estimated the scale of work involved in adapting IT systems, cited as the single largest reason for budget overruns.



VAT now applied in over **166 countries** at varying rates. **India** is now the **highest** at **28%**, exceeding **Hungary's 27%**.

Spotlight on Malaysia

Malaysia introduced GST two years ago, and GDP declined from about 5% in 2015 to 4.2% in 2016, according to the World Bank.
But that was more a result of falling commodities prices, especially oil and gas, with export revenue from the latter falling significantly, according to economists.

Observers said GST helped to depress consumer spending amid a general downturn in Malaysia last year, but there were now signs things were picking up, reinforcing the view that after an initial hit from a new tax, businesses could get used to the new regime and trading return to normal levels.

A World Bank report said: "Malaysia's growth rate slowed quite sharply in 2016, and that was actually warranted as the country introduced fiscal policies to adapt to low commodity prices."

But private consumption has shown some recovery in Malaysia and data has illustrated that the economic outlook has improved significantly, according to a report published by Focus Economics on 22 August 2017.

Shilan Shah, analyst at Capital Economics, based in Singapore, interviewed for this article, said with GST pitched at the Malaysian level "there is an initial knock, but in the medium-term trade returns to normal as long are there is reasonable underlying demand and the tax isn't too high, or later increased incrementally".

A lesson from the past: UK

Sometimes things don't always go according to plan. Take what happened in Britain in 1983 when the UK government introduced VAT on gold bars and coins at 15%. "It killed the industry," claimed Tony Dobra of London-based Baird & Co.

The UK move was aimed at investors in gold bullion, acquired during that time as a hedge against inflation or, in the case of the 2008 financial crisis, because of its inherent value during times of uncertainty.

What does Dobra thinks of Dubai's plans to introduce VAT at 5%?

"I think my quote at the DMCC's Dubai Precious Metals Conference [9-10 April 2017] was keep it simple, and keep it low. Then there are the details to iron out. If you sell second-hand jewellery, is it a reduced rate or full-rate? What counts as second-hand jewellery? What counts as scrap jewellery? Or antique jewellery, and so on."

Jeffrey Rhodes of Rhodes Precious Metals Consultancy, based in Dubai, said a 5% tax on the value added, in other words on the mark-up over and beyond the price of the metal, would be "acceptable."

India GST

A GST was introduced in India on 1 July 2017 in one of the biggest tax overhauls since independence in 1947. The new tax replaced a plethora of state taxes, as well as a number of centrally imposed levies, in a move that economists predicted will boost internal trade, lift GDP in the medium term, widen the tax base and help reduce dependence on the informal (untaxed) economy. The latter has been a prime target of Prime Minister Narendra Modi's reform programme that aims to modernize India's economy and facilitate development.

Writing in June 2017 in India's Business Standard newspaper, Surendra Mehta, the national secretary of the India Bullion and Jewellers Association, noted that businesses paid taxes on bullion under the old system that worked out at about 12.43%. Under the new GST, the burden had risen only marginally to approximately 15.67%. Mehta said: "So, the effective price escalation on gold jewellery comes to 3.24%. This is still a win-win for gold jewellers; they would not have expected anything better than this."

A paper published by the World Gold Council in June, said while gold consumers in India face a slightly higher tax rate, and that the industry will go through a period of adjustment, "we see the net impact on the gold industry as being positive".

"The gold supply chain should become more transparent and efficient, and the tax reform could boost economic growth, which we see as supporting gold demand," said WGC.

It added that new measures from the Bureau of Indian Standards is pushing the industry towards mandatory hallmarking, which will also tackle the issue of under-carating.

"The direction of travel seems clear to us: India's gold market is becoming more organised and transparent. This should be good for consumers. They can have more faith in the gold products they are buying, and this in turn can support gold demand in the years to come", WGC added.

Shah, India analyst at Capital Economics, said there was potential for disruption in the

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near-term but in the medium term, he thought there would be quite a big benefit. “We should see growth pick up towards the end of this year, and into next year as well. Although I don’t think it will be growing at 10% or 12% anytime soon, I think it’s quite feasible for the Indian economy to improve from where it is now at about 6%, to around 7%.”

The implications of demonetisation introduced in India last year are still being hotly debated. The move involved the scrapping of large-dominated notes, equivalent to 86% of the cash economy, as part of an attempt by Prime Minister Modi to crack down on illegal cash piles in the informal economy. But the upheaval has affected spending and growth. A report from Trade Economics, drawing on official Indian data, said the Indian economy expanded 5.7% year-on-year in the second quarter of 2017.

This was the weakest growth rate since the first quarter of 2014 due to a slowdown in consumer spending and exports. “Figures for the second quarter mark the third consecutive period of slowing growth, following the demonetisation programme started in November of 2016,” said Trade Economics. The third quarter will show if GST has also had an effect, said the organisiation.

Williams at Capital Economics said the price of most goods and services are expected to increase in the immediate aftermath of the tax, with economic growth slowing down over the next few months, but it should pick up after the tax is fully implemented, he said.

Positive potential for UAE - but preparation is vital

The International Monetary Fund has said any tax system can be designed to minimise its impact on the economy. The main economic cost of VAT is to raise the price level. However, since most goods and services are taxed, and taxed at the same rate, there is limited opportunity for households to avoid VAT by changing their consumption patterns. And, if pitched at a moderate level, does not necessarily have a large impact on the pattern of consumption going forward, said the IMF.

In other words, the hit on economic activity may be relatively small initially, and neutral or even positive in the medium term. In the initial phase, implementation is an important factor to take into account.

A recent guide published by the UAE Ministry of Finance said businesses may need to make some changes to their core operations, their financial management and book-keeping, their technology, and perhaps even their human resource mix (e.g., accountants and tax advisors).

The Ministry said it is essential that businesses try to understand the implications of VAT now and once the legislation is issued make every effort to align their business model to government reporting and compliance requirements. "We will provide businesses with guidance on how to fully comply with VAT once the legislation is issued.

"The final responsibility and accountability to comply with law is on the business".

In the announcement unveiling the new tax system on 28 August 2017, His Highness Sheikh Hamdan said it will provide extra support for the government to implement the vision of the UAE leadership and build a diversified and productive knowledge economy."

His Highness Sheikh Hamdan added the introduction of VAT would ultimately have positive results on the economy, "far exceeding its 5% rate, given that revenues will be redistributed to development projects that benefit society at large and accelerate progress until the UAE reaches the top of global rankings across all sectors".

Additionally, "the UAE is making sure the region remains an extremely competitive global trade and finance hub as it will allow foreign businesses to recover the VAT they incur when visiting the UAE. This is important as it encourages them to do business and also, because a lot of other countries have VAT systems, it protects the ability of UAE businesses to recover VAT when visiting other countries (where the rates are a lot higher)," said UAE Ministry of Finance.

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There are several steps that businesses should consider for VAT readiness.

01

Preparation

Prepare a project plan to identify and secure additional internal and external resources. VAT will impact most areas of the business including; finance, IT, HR and legal teams.

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02

Assessment

Map the current business transactions and overlay the VAT footprint to assess impact of new law. Businesses may need to make some changes to their core operations, such as financial management and book-keeping, their technology, and even their human resources mix (e.g. accountants and tax advisors).

DMCC Business Apps Manager is a centralised platform that can support with VAT readiness through its network of integrated apps for payroll, customer relationships & sales, accounting and a complete compliant UAE labour law tool. Find out more: **www.dmcc.ae/businessapps**

03

Training

Employee training must be conducted to ensure employees understand the process and requirements for VAT. Training should cover changes to systems, controls, reporting and governance.

DMCC Authority will be conducting free training and education sessions in order to assist its member companies to prepare for VAT. For more information visit **www.dmcc.ae/events**

04

Registration

Assess the registration and VAT compliance requirements. Registration for VAT is expected to be made available to businesses that meet the requirements criteria and will open during the third quarter of 2017 on a voluntary basis and fourth quarter of 2017 on a compulsory basis.

For the latest information on the introduction of VAT visit www.dmcc.ae/vat

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About DMCC

Dubai is perfectly positioned at the centre of the world of trade, connecting East with West and North to South. DMCC is at the heart of Dubai with a mandate to develop a world class commodities hub through continued innovation. DMCC is Made for Trade.

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