7 November 2019

Indirect Tax Alert

UAE partially exempt businesses should apply for special VAT apportionment methods before 31 December 2019

Executive summary

The United Arab Emirates (UAE) Federal Tax Authority (FTA) recently issued notices to certain banks encouraging them to apply for special Value-added Tax (VAT) apportionment methods where the standard input-based method is not appropriate. Even though the notices were only issued to certain banks, the wording indicated that businesses in other partially exempt industries may also be impacted. According to the notice, businesses that consider the standard apportionment method to not be appropriate should apply for a special method by the end of this year, i.e., by 31 December 2019. Taxpayers failing to submit applications within this period could be prioritized for a full VAT audit in 2020.

Detailed discussion

In the course of carrying on a business, taxable persons in the UAE incur expenses that are subject to VAT. Taxable persons may generally recover VAT to the extent the costs are incurred to make taxable supplies. Where a business makes both taxable and exempt supplies, only a portion of the VAT incurred may be recovered where the cost cannot be directly attributed to either the making of wholly taxable or wholly exempt supplies, i.e., mixed expenses.[1] In this instance, the taxable person must use an approved apportionment method to determine the extent of VAT recovery in respect of mixed expenses. The standard apportionment method is based on input tax,[2] which may not be appropriate in the case of certain industries, especially:

- Banks
- Life insurance companies
- Other financial institutions
- Real estate businesses
- Passenger transport companies

In December 2018, the FTA introduced alternative apportionment methods,[3] which may be considered where the outcome of the standard input-based apportionment method is not reflective of the actual use of acquired goods or services. These special methods include the output-based method, transaction count method, floorspace method and sectoral method. Taxable persons apply these special methods to make an adjustment after the end of the tax year, unless the FTA has approved the method for use in each taxable period after review of the taxable person's special apportionment method application.

In the recent notices, the FTA requested banks to submit their applications for special VAT apportionment methods before 31 December 2019 if the standard method is not appropriate for them; that is, where the VAT recovery rate is not a fair and reasonable reflection of the actual use of goods and services acquired. This will allow businesses greater certainty over their level of input tax recovery as they will be using a methodology that has been approved by the FTA.

The notice states that taxpayers failing to submit applications within this period will be prioritized for a full VAT audit in 2020. If the FTA identifies a significant variance between the input tax recovered under the standard method and the input tax recovered under the actual use calculation, the FTA may take the view that the standard method is not accurately applied by the taxpayer. In such instance, the FTA may perform a detailed review of the input tax allocation under the standard method.

Implications

Partially exempt businesses should determine as soon as possible whether the standard VAT apportionment method's outcome is a fair reflection of the actual taxable use of goods and services. If the standard method is not appropriate, the business should apply for a special apportionment method as soon as possible. Failure to apply for a special apportionment method before the end of 2019 may result in a full VAT audit.

Endnotes

1. Article 54 of the Federal Decree-Law No 8 of 2017 on Value Added Tax (Decree-Law) read with Article 55 of Cabinet Decision No (52) of 2017 on the Executive Regulations of the Decree-Law (Executive Regulations).
2. Article 55(5) of the Executive Regulations.
3. Input tax apportionment: Special methods VAT guide (VATGIT 1) published by the FTA in December 2018.

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EYG no. 005040-19Gbl

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