



Client Alert

November 2018

Managing VAT in the UAE: Gearing up for end-of-year input tax adjustments

The first anniversary of the introduction of Value Added Tax (VAT) in the UAE is fast approaching and, where applicable, many businesses have little time left before the end of their first tax year to carry out any required end-of-year input tax adjustments. Partial exempt taxpayers (ie, taxpayers that carry out both taxable and exempt supplies or non-economic activities, such as banks, holding companies, life and non-life insurance providers, charities and real estate developers) are required to review and analyze their input tax recovered over the course of the year. In certain cases, the end-of-year adjustments may result in a change to the amount of VAT that can be recovered for the year.

Below are a few tips and reminders for you to consider to make your end-of-year adjustment process smooth and less taxing:

1. Determine your tax period.

Tax year

The tax year may differ from the calendar year and depends on the taxpayer's tax period. For a taxpayer that submits VAT returns on a monthly basis, the tax year ends on the last day of the calendar year.

For a taxpayer that submits VAT returns on a quarterly basis, the tax year is identified as follows:

- Where the tax period ends on 31 January and quarterly thereafter, the tax year ends on 31 January;
- Where the tax period ends on last day of February and quarterly thereafter, the tax year ends on the last day of February; and
- Where the tax period ends on 31 March and quarterly thereafter, the tax year ends on 31 March.



Any end-of-year input tax adjustments should be filed in the first tax period of the subsequent tax year. Thus, for a taxpayer submitting monthly returns, adjustments should be filed in the VAT return for January, whilst for taxpayers submitting returns on a quarterly basis, this would depend on the quarter on which the previous tax year ends.

2. Confirm whether you need to carry out end-of-year input tax adjustments.

Annual adjustment

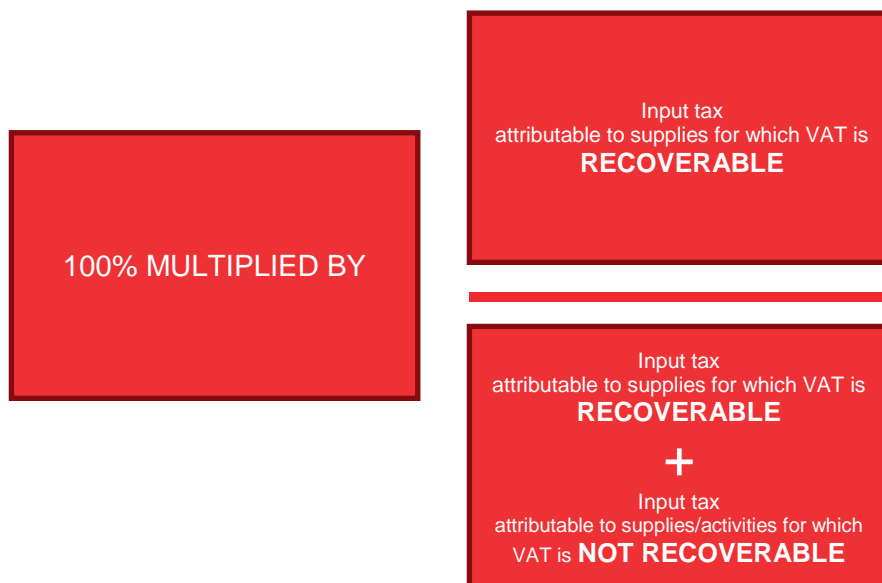
Taxpayers that incur input tax for making exempt supplies or non-economic activities are required to calculate and determine the input tax recoverable in relation to those supplies in each tax period. This entails a two-step process:

Step 1: Direct attribution

Taxpayers need to attribute the input tax incurred on an expense that is wholly used to make a supply, to that particular supply. The input tax may either be fully recoverable or irrecoverable depending on the type of supply that the expense (on which the input tax was incurred) can be attributed to.

Step 2: Attribution of residual input tax on the basis of the standard method

Taxpayers need to determine the extent of recoverable input tax that cannot be attributed to a particular supply (overhead or residual input tax) based on a percentage (rounded to the nearest whole number) which is calculated according to the following formula:





At the end of each tax year, the taxpayer is required to carry out the same calculation in respect of the entire tax year. The aim of the annual adjustment calculation is to correct any fluctuations in the percentage of recoverable input tax which has already been calculated and claimed in each tax period during the course of that tax year. There is no de minimis provision applicable to the annual adjustment calculation.

3. Review whether the recoverable input tax calculated on the basis of the standard method, reflects actual use. If not, analyze and determine which alternative proxy would provide a fair and reasonable result. Document the entire review process.

Actual use adjustment

After carrying out the annual adjustment calculation on the basis of the standard method, the taxpayer may also be required to make an adjustment to the input tax recovered on the basis of actual use (ie, a basis that is fair and reasonable). What is fair and reasonable will depend on the type of expense in respect of which the input tax has been incurred, and the onward supplies that these expenses can be attributed to. Alternative proxies to determine fair and reasonable input tax recovery may include transaction count or turnover value.

If the difference between the recoverable input tax calculated on the basis of the standard method (after the annual adjustment calculation) and that calculated on the basis of actual use is more than AED 250,000, the taxpayer is required to make the actual use adjustment. It is important that the taxpayer produces a file evidencing that the actual use analysis has been carried out and the process that has been followed to determine the proxy that reflects a fair and reasonable recovery of the input tax.

4. Ascertain whether an expense incurred on assets qualify under the Capital Asset scheme, and verify the amount of input tax (incurred on the relevant expense) recovered in the tax periods during the year, and the actual use of the capital asset. Maintain a register to keep track of the adjustments.

Capital Asset scheme

This is only relevant for taxpayers that have acquired or produced assets in the 2018 tax year on which VAT is incurred and that are subject to the Capital Asset scheme. Assets or expenses incurred from them qualify under this scheme if they are valued at over AED 5 million (excluding VAT) and have an estimated useful life of more than 10 years (for buildings) or 5 years (for capital assets other than buildings). In some cases, staged payments in relation to the construction, purchase, refurbishment, extension or other work undertaken for a building are grouped together and treated as one single capital asset.

Under the Capital Asset scheme, taxpayers are required to monitor and adjust the input tax incurred on an asset over a period of 5 or 10 years, depending on the nature of the asset. The first capital asset adjustment year ends when the



first tax year ends. The percentage of input tax recoverable depends on the use of the capital asset (which may differ from the percentage of input tax recoverable that is applied to the business as a whole). In addition, all taxpayers acquiring capital assets are required to maintain a capital asset register.

Following the application of the actual use adjustment, the taxpayer is required to adjust the input tax incurred on the acquisition or construction of the capital asset in the first tax year, on the basis of actual use. From the second tax year onwards, the taxpayer needs to compare the input tax recovered in the first tax year with the input tax recoverable in the subsequent years, on the basis of the use of the capital asset in the current tax year. Thus, the VAT incurred in the first tax year is revised each tax year after the first year (ie, total of 9 if the period is 10 years, or total of 4 if the period is 5 years) following this methodology.

How we can help you

We are happy to assist you with your end-of-year input tax adjustments. We can review your annual adjustment calculation, and carry out an actual use analysis to determine the apportionment proxy for fair and reasonable input tax recovery, whilst documenting the entire review and analysis. We can also assist you in identifying which assets qualify under the Capital Asset scheme and determine the percentage of input tax recoverable for those capital assets.

You can also visit our Middle East Insights and GCC VAT websites to view this and other materials:

- <http://me-insights.bakermckenzie.com/>
- <http://www.bakermckenzie.com/en/insight/publications/2017/10/doing-business-gulf-vat-regime>

To speak to us in relation to any VAT issues in the UAE and Middle East, please feel free to contact one of the lawyers below, or your usual Baker McKenzie contact.



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