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Council Report:

Preparing for VAT and Excise Taxes in the U.A.E.: An Update

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After years of discussion, the Gulf Cooperation Council (GCC) now appears close to finalizing Value Added Tax (VAT) and Excise Tax treaties. Driven by persistently low oil prices, GCC states have reportedly been discussing the prospect of a 5% VAT as well as Excise Taxes as high as 100% on certain goods, such as tobacco. Such discussions could culminate in the signing of formal treaties as soon as the end of the year. These treaties, in turn, could then lead to the implementation of national-level Excise Tax legislation as soon as January 2017 and national-level VATs as early as January 2018. Should these taxes be implemented, they would potentially both dampen profits and raise compliance challenges for many companies operating in the U.A.E., while also offering opportunities to select others. Many Business Council member companies have been in direct contact with the U.A.E. government and have worked through the Council to minimize some of the most negative components to businesses of these taxes.

Why Implement These Taxes Now?

Although GCC states have long discussed Excise Tax and VAT treaties as ways of diversifying their revenue streams, stubbornly low oil prices have given increased urgency to these discussions.[i] After all, these states are heavily reliant on oil revenues to finance their budgets, and **lower oil prices have led to sizeable budget deficits**.[ii] GCC states have sought to plug budgetary holes by trimming expenditures (slashing subsidies) and drawing on their significant financial reserves. However, the unsustainability of the latter has prompted GCC states to look for new sources of revenue as well.

In so doing, GCC states have turned to VATs for a variety of reasons. As Deloitte noted in a recent report, broad-based VATs at a low rate generally have a “relatively small negative impact on GDP growth and unemployment.” After all, **the majority of a VAT usually falls on consumers rather than businesses**, and a VAT is thus “less likely to distort investment decisions by businesses than any form of direct tax.” In addition, according to Deloitte, inflationary impacts from VATs are often “relatively small and typically limited to the period immediately after implementation.”[iii]

Meanwhile, GCC states have turned to Excise Taxes because they double as a tool of achieving social change. All GCC states have high levels of smoking, with a recent study showing the number of smokers ranging from a low of 13% in Oman to a high of 31% in Kuwait.[iv] GCC states also suffer from high rates of obesity, diabetes, and associated illnesses. **Excise taxes on tobacco and sugary beverages can incentivize GCC citizens to adopt healthier lifestyles** as well as procure revenue for state coffers.

How Will These Taxes Be Structured?

The GCC has not released full details about these prospective tax treaties, and some of these details have reportedly yet to be determined. However, GCC officials have offered some indications as to the broad outlines of what has thus far been agreed.

In regards to the VAT treaty, GCC states have decided that all countries will simultaneously implement national-level VAT laws that will be guided by common rules on VAT across the GCC.[v] They also agreed to introduce a **unified VAT of 5% in 2018 that would exclude the healthcare, education, and social service sectors as well as nearly 100 staple food items**.[vi][1]

As for the Excise Tax treaty, GCC Finance Ministers reportedly agreed in November 2015 to impose a **100% excise tax on tobacco** and related products in 2017.[vii][2] GCC states may have also agreed to other excise taxes as well, with Saudi Arabia’s OKAZ newspaper reporting in January 2016 that these states decided to impose a **unified tax of 50% on soft drinks and 100% on energy drinks** in addition to the aforementioned 100% tax on tobacco products.[viii]

When Will These Taxes Be Implemented?

A 16 June 2016 extraordinary meeting of GCC Finance Ministers in Jeddah both affirmed and clarified the prospective timeline for the implementation of these tax treaties.

After the meeting, Bahrain’s Finance Minister, Sheikh Ahmad bin Mohammed Al Khalifa, reportedly announced that the ministers had approved in principle the introduction of a GCC VAT. The Minister added that **GCC countries would be ready for the first phase of VAT implementation by the beginning of 2018**. As such, Ernst & Young (EY) expects that a VAT Framework Agreement will be finalized at the next meeting of the GCC Financial and Economic Cooperation Committee in October 2016.[ix]

Also during the meeting, according to PricewaterhouseCoopers (PwC), GCC Finance Ministers approved in principle an Excise Tax treaty. PwC claims that this treaty will be the basis for the issuance of **national Excise Tax legislation that could be implemented as soon as the beginning of 2017**.[x]

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[1] These exclusions are likely motivated by a desire to cushion the impact of any VAT on low-income families, particularly given that VATs can be regressive means of taxation in relative terms.

[2] As there was already a 100% customs duty on such products, this decision effectively increased the tax on tobacco in the GCC from 100% to 200%.

In this regard, it is important to note that the U.A.E. may lead the way in the implementation of some of this legislation. Indeed, in March 2016, Elena Roadhouse, a Reuters' reporter and Senior Legal Analyst with ONESOURCE Indirect Tax, claimed that **the U.A.E. would be the first to implement a VAT in January 2018, and that other GCC countries would follow suit by the end of that year.**[xi]

What Will This Mean for Businesses in the U.A.E.?

Those businesses that will be most heavily affected by this tax legislation are naturally those in industries that are specifically targeted by the proposed Excise Tax treaty. Indeed, **excise taxes are likely to suppress both sales and profits for tobacco companies and beverage companies alike**. This situation could be exacerbated for tobacco companies if the manner in which this legislation is implemented gives rise to smuggling networks dealing in contraband tobacco goods.[xii]

Certain other businesses will also be affected more than others by this legislation due to the exclusion of some sectors of the economy from the proposed VAT. Along these lines, a recent survey of certified financial analysts (CFAs) by CFA Society Emirates found that these **experts expected the luxury goods, automobile, tobacco, and real-estate sectors to be the most affected by additional VAT costs. Meanwhile, they expected the healthcare sector to be affected the least**.[xiii]

For those companies that are heavily affected by VAT, it could certainly dent their profits. Even though a VAT is a tax on consumption and is generally passed off to consumers, **the real increase in prices of goods that a VAT entails could reduce demand for these goods** and thus hurt the revenues of their producers. Some businesses may choose to absorb part of the VAT so as to maintain an optimal balance between their margins and sales.

Companies across the board will also be impacted by the challenges of complying with new tax legislation. Companies will progressively need to register for VAT, and they will subsequently be required to account for VAT on an ongoing basis to the Ministry of Finance.[xiv] [3] As such, **they will need to ensure they have adequate capacity to comply with these accounting requirements**, both in terms of equipment and personnel. This may involve training staff, hiring new employees, implementing new IT systems, or perhaps seeking outside help.

In this regard, while this new tax legislation provides challenges to many companies operating in the U.A.E., it offers opportunities to select others. Indeed, in June 2016, Zawya, a regionally focused business intelligence and news company, cited industry expert predictions that **the introduction of VATs in Gulf Arab States would create more than 5,000 new jobs for tax and accountancy executives**. In fact, Zawya claimed that many of the major international accountancy firms – PwC, Deloitte, EY, and KPMG – had already begun hiring in anticipation of a surge in business.[xv] Opportunities may exist for enterprising companies in other domains as well – such as recruitment firms and companies providing accounting systems.

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[3] The Undersecretary of the U.A.E. Ministry of Finance reportedly said in June 2016 that companies in the U.A.E. with annual revenues over 3.75 million AED "will be obliged to be registered under the GCC VAT system" in early 2018. The Minister added that all companies will eventually be obliged to register.

[i] http://www.kpmg.com/AE/en/Documents/2016/VATinOmanandGCC2.pdf; http://www.emirates247.com/news/emirates/soft-drinks-in-gcc-may-be-costlier-2012-05-08-1.457717

[ii] https://www.imf.org/external/np/pp/eng/2015/111015.pdf

[iii] http://www2.deloitte.com/content/dam/Deloitte/xe/Documents/tax/me_tax_VA-%20in-the-GCC-Old%20news%20or%20new%20chapter.pdf

[iv] http://www.khaleejtimes.com/nation/uae-health/will-a-100-rise-in-tobacco-taxation-help-quit-smoking

[v] https://www.imf.org/external/np/pp/eng/2015/111015.pdf

[vi] http://www.arabnews.com/economy/news/865611; http://www.emirates247.com/news/emirates/vat-in-gcc-gulf-states-agree-on-key-issues-says-uae-official-2015-12-07-1.613145; http://gulfnews.com/business/economy/gcc-states-in-agreement-on-5-vat-1.1677576

[vii] http://www.bna.bh/portal/en/news/695252; http://www.khaleejtimes.com/nation/uae-health/will-a-100-rise-in-tobacco-taxation-help-quit-smoking

[viii] http://www.arabianbusiness.com/gulf-states-set-for-100-tax-on-energy-drinks-tobacco-618052.html#.V4T6OvkrLct; http://www.arabnews.com/economy/news/863486

[ix] http://www.ey.com/Publication/vwLUAssets/GCC_Ministers_of_Finance_meet_to_approve_introduction_of_GCC_VAT/$FILE/2016G_01656-161Gbl_Indirect_GCC%20Ministers%20of%20Finance%20meet%20to%20approve%20introduction%20of%20GCC%20VAT.pdf

[x] http://www.pwc.com/m1/en/media-centre/2016/gcc-companies-should-take-action-now-to-prepare-for-vat-and-excise-tax.html

[xi] https://tax.thomsonreuters.com/blog/onesource/vat-gst-management/vat-new-hot-commodity-gcc-members/

[xii] http://www.thenational.ae/business/economy/taxing-question-of-curbs-on-tobacco-smuggling

[xiii] http://www.bq-magazine.com/economy/macro-economy/2016/06/introduction-of-vat-in-the-gcc-region-will-lead-to-increased-inflation-rates; https://www.cfasociety.org/uae/Pages/default.aspx

[xiv] http://www.ey.com/Publication/vwLUAssets/GCC_Ministers_of_Finance_meet_to_approve_introduction_of_GCC_VAT/$FILE/2016G_01656-161Gbl_Indirect_GCC%20Ministers%20of%20Finance%20meet%20to%20approve%20introduction%20of%20GCC%20VAT.pdf

[xv] http://www.zawya.com/mena/en/story/ZAWYA20160627072518/