



Economics of VAT in UAE

Ms.Preeti Raj Kaur
(Economist) k.preetiraj@gmail.com

Introduction:

A new era is going to start in the UAE with the introduction of Value Added Tax (VAT) in the economy. A truly global economy which is doing better than the best for its growth and development. So there are certain questions regarding VAT as what is VAT, its implementation and its importance in the economy. As the UAE government is working towards the implementation of VAT in the first quarter of 2018.

Firstly let's talk about the Value added Tax (VAT), which is also known as Goods & Service Tax (GST) in some economies. The VAT is a tax which is assessed and collected at every loop of the sale and purchase in the market chain. Under this system seller works as a link between the buyer and the government, which collects tax (calculation of tax amount is based on the value addition to the good) from the buyer and handing over to the government. Here one thing we need to understand that although VAT seems same as Sales tax but it has a different mechanism, as VAT is collected at each step of the production process by the seller from the buyer where as sales tax is levied on the total value of the commodity. VAT is generally added in the shelf price of goods, so consumers or sellers are not supposed to make any extra calculation for assessing the price to be paid. All the countries which are using VAT have different rates and different slabs for varying categories of goods. To

understand the concept of VAT in a lay man's language, let's consider the production process of tea, where with the transfer of tea leaves to different levels it gets value addition in the process of cultivation, processing, packaging, transportation and marketing, which adds value to the leaves of tea garden and all these work does require funds, which multiplies the goodness of the product as well as adds the value to the product. One thing we need to consider is that the VAT is paid at each level of this production process and being reimbursed by the next buyer in this cycle.

Methods to calculate VAT

There are basically two methods to access the amount of VAT i.e.: invoice based method or credit invoice and the other method is accounts based method or subtraction method. In invoice method calculation is done by subtracting tax on purchase bills from the taxes on the sales bills. As tax is payable at every stage, so there are almost no chances of loss of revenue under this process. Even if tax evasion is done at any stage, it can be recovered by the government in full at the next stage. The only limitation of this method is evasion of tax by fake invoices. So adequate measures should be taken by government to check the authenticity of invoices produced. Under subtraction



method the tax amount is calculated by subtracting Purchases (excluding taxes) from the Sales (excluding taxes)(i.e.: Taxable Turnover = Sales excluding Taxes – Purchases excluding taxes) . In this method the calculation of duty liability is done periodically (monthly/ quarterly) and not invoice wise. Taxes cannot be shown in invoices.

Calculation of VAT in Dubai

As the Dubai government is planning to implement VAT in the first phase of 2018. All the businesses and trading units are gearing up to complete the pre requisites of registrations, payments, returns and procedure to have a hassle free and smooth implementation of VAT as for all the companies registered under this process are supposed to document their revenue and VAT charges properly. All the firms will be paying 5% VAT on the purchase of goods and services from the dealers and the goods and services provided by them will also be chargeable at a rate of 5% of the invoice value to the customers. Subsequently the VAT charged and paid will either be given to the tax authorities in the UAE or be retained by the seller as per the condition. The important point is that the government is never directly involved in this tax collection process and this is the reason why it is also known as indirect consumption tax and makes it more important to keep the proper record of all the transactions to access the actual amount of final tax paid by the final consumer.

Effects of VAT on various sectors

Payment of any type of tax gives a unpleasant feeling to the tax payer irrespective of any level of benefits received by them. Implementation of VAT will be a point of little concern for small business units in terms of expenses on implementation of VAT procedure and secondly in terms of little increased prices of goods and services which can affect their volume of sales. As for big business houses it is not a dwelling situation as they can very easily cover up their cost on Vat implementation. Moreover they are quite clear about the tax burden which they will try not to shift to their customers in this competitive market situation. So gradually all the business units are going to get benefitted in dual way. Firstly, as there is no tax cascade effect in the case of implementation of VAT (in case of any other tax implementation chance of tax cascading is always there), secondly they can reclaim all the expenses made by them in production process. For the GCC resident it is not going to affect their purchase of essential goods and health care services. The effect of VAT will be more on high income earners in the GCC (the more you spend the more you pay). Those who are spending willingly on restaurants, leisure and entertainment will end up paying a little more out of their disposable income. All the people going for big investment (i.e. cars) will not be affected by a little increase in the price of their priced possession.

As predicted by the IMF there is a possibility of combined deficit of about US



\$350billion over a period of next five years to be faced by the GCC countries, which can affect the oil prices in the region up to \$ 56 per barrel. So, to avoid any situation of borrowing to meet this deficit government should look out for non-oil revenue sources to get rid of such a financial situation. As VAT is expected to generate one fourth of deficit recovery funds which amounts to the 1.5% of the GDP. There are also many big projects (new motorways, multispecialty hospitals, 5.5bn Sewage tunnel and the mammoth Dh. 84.4bn Barakeh Nuclear power plant) in the pipeline and will soon serve the residents of UAE region, raising their living standard to a new level. Anyways services and benefits provided by the government is far more than what government will be charging now. There will be many more direct and indirect benefits to the people living in UAE and a little price for a high raise in living standard is like a win win situation for the residents of UAE.

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