

IMPACT OF VAT ON UAE ECONOMY



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ABSTRACT

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The local people and the immigrants that lived in UAE have had enjoyed the free tax system of the kingdom for years now and now a sudden change to this system is bound to have an impact not only on the economy, but on way business has been done before and now. The reason for the UAE to decide to implement the tax system in their kingdom is due to dropping oil prices around the world, which is decreasing the kingdom's revenue and to stabilize this revenue the government has decided to implement tax system. The United Arabs Emirates announcement in 2011 which was to embark on a process of developing a VAT which was proposed to be 5% rating which was going to be implemented in 2014 or by 2015. The ministry of finance finalizes a report on the study of social and economic effects of the same VAT which would have on the nation upon fully implementation which was approximated to take 3 years from a point which the all general principles and laws were agreed upon all member countries of the union of GCC. Though the implementation of VAT is more likely to provide the government with the necessary revenue their need to maintain the functionalities, but at the same time it is going to raise up several challenges, such as tax fraud. Since, business is going to have an extra expenditure and to get rid of this extra expenditure it is very likely that the business organization can resort to tax fraud as seen in many other countries. This tax fraud is a grave issue to any government as it increases corruption in a country. Hence, the government needs to increase its vigil so that it can keep this threat under control and ensure the liability of tax.

1. INTRODUCTION

1.1 Background of the study

Gulf Cooperation Council (GCC) is a council that comprise of six-member states which come together in in a joined union of free trade area with the same external custom tariff in January 2003. Upon the GCC member states agreement in January 2008, they decided to launch a common market with the aim of increasing investment and trade between the member countries. But for this to become successful the GCC member countries agreed to implement the Value Added Tax (VAT) system across all the GCC member states with the help of the International Monetary Fund (IMF), they also agreed to implement New Zealand VAT system with the VAT rate of 3 to 5% being proposed. The United Arabs Emirates announcement in 2011 which was to embark on a process of developing a VAT which was proposed to be 5% rating which was going to be implemented in 2014 or by 2015. The ministry of finance finalizes a report on the study of social and economic effects of the same VAT which would have on the nation upon fully implementation which was approximated to take 3 years from a point which the all

general principles and laws were agreed upon all member countries of the union of GCC. The principles which were agreed upon on were strictly within the member states of GCC which on implementation of VAT tax system will improve the economic scale of the member states of GCC if adopted. If VAT system will be implemented, it will improve the collection and sharing of the treaties within the seven-member countries of UAE. The VAT system will improve the and replace the current arrangements in UAE where the government revenue is collected as a way of custom duties which create a potential that will results in substantial variation in revenue collection in the UAE countries.

Finally, UAE is the most important agricultural economy which is potentially an important commercial port of the UAE economic scale i.e. The RAK Investment Authority. The UAE is now concentrating on improving the attraction of the foreign investment which the country included outsource and off-shoring. Which was discussed for the introduction of new policies and regulations in both RAK and UAE, which was the including the security and confidentiality which was going to be guaranteed to all foreign business enterprises which had only the international clients where its activities will not be able to attract local taxes to the investment companies, in addition the foreign investors and entrepreneurs may be able to access local bank accounts that make tax free investments and acquire local mortgages to make investment in local assets. This investments policy required that the foreign firms would acquire and own property in UAE trade zones which would attract foreign investments and they can give the employment visas to clients. The executive and workers of foreign investments from India, Middle East, Europe, America, Africa and South-East Asia are employed in this investment, the government embarrasses this kind of policies of attracting international business as it withdraws from other foreign investments. All will be if the if the VAT will impact on such initiatives. The importance of this study was to analyze the impacts of the proposed the new VAT systems and how it will impact on the economy of the UAE, due to this on focus in on implementation on UAE, on instant implementation it will identify policies and imperatives which must be addressed to ensure economic importance for the whole country. It was critical and a simple principal of the VAT taxation regime which is examined carefully which can be understandable to implement it.

1.2. Why the UAE Opted for VAT?

After UAE brought in the VAT or the Value Added Tax, the IMF suggested that the implementation of VAT comes with the federal government of UAE having no way to control the situation. The governments of Emirates and UAE, the governments gave its citizens and the people living and working in their country many benefits which include medical, transportation and public-school facilities. All these services were unconditionally provided to their people from the percentage they included in the budget for public welfare. VAT will bring a new income source to the country. This will also improve the quality of public services provided by the government, not only in the present but also in the future and coming days. Support will also be provided to the government of UAE to go ahead to pursue their plans to make them more independent of revenue from their oil and petroleum sources. They in short, have made plans to set themselves free from their traditional sources of income.

Fast paced growth ambitions of the UAE and the region and introduction of VAT constitute an important policy reform aiming to help GCC governments to achieve medium to long term social and economic policy goals (Cynthia Ang, meinsurrancereview.com). The plans of UAE to move at a faster rate towards growth is being facilitated by the introduction of VAT. The VAT system of tax holds a very important scheme that can help reform the GCC government and attain a long term economic and social prosperity (Cynthia ANg, meinsurrancereview.com)

2. IMPACTS OF VAT ON UAE

According to social economic impacts are in line with international experience, at the rate of 5% which will cause a general in rise levels and parallel one-off rise in the rate inflation from 0.4 to 1.4%, which is going to depend on the primarily on the degree of the increase to a CET, the scholars indicated several factors which will determine

whether this results are going to increase in inflation rate, especially weather the question of employees may be going to obtain higher wages which would compensate as a results of increase in prices, and the way the government will be going to react in terms of government spending its revenue and it monetary policies, Deloitte also made an assumption that the VAT rate of 5% is going to increase between 0.2 and 0.4% of the GDP, but he was clear in saying that the results will mainly be depended on which the goods and services will be going to be categorized which is ultimately be excluded from the VAT and how many investments companies will be going to pay tax using VAT. Also, disparities occurred in the coverage of the VAT and the efficiency of the collections which are going to affects this estimate. However, global experience on the disparities indicates that the VAT will raise significantly in terms of more revenue and other forms of the taxations. Other factors which were analyzed were among different ethnic groups, their income levels were analyzed in Emirates. However, Deloitte did not find marked groups between the nationality groups, but he generally proposed that western households were likely to be more affected. Regarding to this, the household income the analysis confirmed that it affected the VAT regressively, resulting in household's disproportionality. This was even with expenses such as foods which are exempted the regressively remained (Buettner, 2008). The disadvantaged of this initiative was it was compensated more efficiency in some of the instances which means social security budget will have the tendency to balance any negative or unequal impacts on smaller emirates households by the same scholars. It was also had been recommended at the same time that if more VAT revenue will be allocated to more collected from emirates which will benefit the funds that would not be recommended an not necessarily be withdrawn from the emirates accounts depending upon the revenue sharing agreements where the large portion of the revenue will be allocated to relevant state agencies UAE, this is while the social security funds would be held by the federal governments, however, the average results in across Emirates is compared, the effect will be analyzed to be more greater in smaller emirates, which describe the contributions in each emirates to the United Arabs Emirates GDP, these was with the exception of Abu Dhabi and Dubai which are major cities in UAE, the table give evidence that the more smaller the Emirates are more heavily depended upon the larger Emirates, Even though the VAT system in New Zealand is the only one member of the nation that is Organization for Economic Co-operation and Developments, (OECD), the budget council with little and more than 4 million people and the resources were limited, a sound VAT was introduced called Goods and Service Tax (GST) which influenced VAT/GST system internationally since its implementation in 1980s, India planned to implement a national GST was an example and the members of Cooperation Council of the Arab states of the Gulf, Asia-Pacific nations are to implement the VAT/GST. New Zealand are examining VAT/GST. This GST in New Zealand was established in October 1996 with the rate of 10%, the rate was raised to 15% in October 2010 (Agha and Haughton, 1996). The GST tax was implemented on consumers in all required goods and services since their prices was incorporated in the levy included imported goods and services. About 20 years since inception New Zealand VAT system was still considered to be the best and more efficient and practice model of this kind of tax which was preferred over the European VAT system. The experts of the economy and specialist considered the New Zealand GST to be one of the best practices due to single rate tax which was applied uniformly to all goods and services for the few zero rate exemptions goods. For this regard the requirements were very simple and clear where the administration and compliance were less cheap. This was fairly to the citizen of New Zealand.

Finally, the revenue which is generated across the GST contribute to 25% to the revenue. The GST tax registered only pay to the VAT on the difference between taxable sales and taxable supplies, which mean that the tax is payables to the tax differences between what is going to be sold and purchased items, is done by reconciling the levy paid to each purchases at standards periods of 2 months, with the enterprises agreeing to choose one to six months periods then that will remit their differences in revenue to Inland Revenue Departments (IRD) is higher sales of GST taxes are higher or be given a refund from the IRD if the tax paid is greater. GST differ from the VAT systems only by small number of exemption permitted, for example, all kinds of foods stuffs which are subjected by GST at the same rate, contrary to the rent collected which comprise of residential rental properties, interest

income, financial services and donations (Cabaltica, 2008). All commercial enterprises exporting properties of goods and services from New Zealand are zero rated, which effect the charge GST at 0%. This allows the commercial enterprises and companies to request the backup inputs GST in the ultimate, non-Zealand based buyer does not pay GST. The supplies exempted in the companies claim back input in GST.

3. TYPES OF VAT AND ITS PROS AND CONS

Principal types of VAT are three which are categorized according to their treatment of deductibility of capital investment. And there are;

- Gross product VAT
- Income VAT
- Consumption VAT

Gross product VAT contain the larger tax base which permits only limited choices such as cost of raw materials and the tax levies purchases of the capital investments. Income VAT is the one which permits additional deductions which allows depreciations on capital goods and the net capital investments purchases, that is the gross investments minus depreciations.

Consumptions VAT allows deductions of the capital investments with the business purchases being deducted from and excluded, the results of the tax base of the total private consumption which is even though the range of the VAT structures and desperate methods of implementations are examined by the broad consensus and of some important issues, first is the agreement is made if the VAT is essentially a consumption tax. A consumption tax is the final base tax. A consumption VAT tax is credited on tax capital goods which is not going to distort or make the prices unavailable of the manufacturers, they encounter when buying or selling goods and services to each other and thus it has advantageous characteristics of maintaining production, and this is imposed at each level of manufacturing of good and services on tax levies, this guarantees that tax only affects the consumption at every level of consumers. It will be necessary to allocate and complete the credit of the tax of the inputs with no breaks in the VAT chain (Ahiakpor, 2010).

Basic three methods of calculating VAT liability, they include

- Credit- invoice method
- Subtraction method
- Addition method

However, there in the most universal global consensus which is credit-invoice method which is the simplest and most efficient to use with the exemption of Japan. At this point it is pertinent to not that of the principal reasons that the credit-invoice which is regarded as the most efficient with the fact that it is clearly linking the tax credit on buyers inputs to the tax remitted by the provider of those inputs to the tax remitted of this inputs which is false undervaluation's of the intermediate sales is discouraged, which means in other words that the way this method is designed is to help to prevent major method of VAT tax fraud thus enhancing compliance. In this regard noted that the important difference between the credit-invoice and the subtraction method is the requirement of the invoice, which he concludes that; the invoice requirement perform two basic functions, which limits the ability of the registered trader to reduce the VAT burden by the offset for cost of the business inputs purchased from the other registered traders to ensure offset is exactly equal to the amount of VAT paid. By ensure symmetry and uniformity between the deductions and inclusions, the invoice requirement is substantially reducing tax evasion opportunities in VAT (Bolton and Dollery, 2005). To cross examine subsection commentary on pros and cons of the VAT system in relation to the number of specific aspects of tax including issues of compliance, impacts on savings, capital accumulation, consumer behavior, productivity, growth, economic efficiency fairness and tax structure.

4. FRAUD, TAX EVASION & COMPLIANCE

As stated above, in 2009, Grinberg mentioned an important feature of credit-invoice technique which helps in lessening the incidence of people evading tax. Some authors say that, certain features of the VAT that are self-enforcing, have a positive effect on tax compliance by stopping frauds and make a way to spot the dent if a fraud occurs. Considering the same issue, the most important process of this method is that there aren't any joint or two-sided economic profits for reporting. While the others say that, taxpayers are baited to make an invoice to improve the sum of the transaction and would therefore leave behind evidence that can be found during audits. Take this example, if a salesperson must convince his/her customer to fail to report the transaction amount due to the VAT credit being lowered, this would be difficult for the salesperson. Alternatively, there is less possibility that the salesperson would work with a customer who preferred to over-report the sale because the salesperson will be made to give an increased VAT. Hence, there are economic benefits on both sides for giving an accurate report of the transaction being made (Ahmad, 2010).

The Tax Structure Commentators usually believe that the minimalism of the VAT system is the best aspect of it. The easiest part of the VAT arises from the nature of tax consumption in this system. If we evaluate the stance of the income tax, the tax for consumption removes any way in which a person's income can be involved. This is because; it removes the requirement for an income tax provision. Precisely, the customer's income tax level has nothing to do with consumption tax. Along with consumption tax, each coinage of currency paid will be included in the tax, regardless of the income level of the customer. One of the other feature included, simplifies the business permissions to establish that the whole expenditure of the total bill. Similarly, there is no compulsion that the VAT should comprise of rules related to profit and loss of capital. Lastly, there isn't any rules on units that are independent.

5. TECHNIQUES FOR ENSURING THE LIABILITY OF VAT

There are 3 separate techniques to make an account of the amount of value that is appended with the VAT system these techniques are as follows:

- Addition
- Subtraction
- Invoice credit

Utilizing the method of subtraction, the amount of total sales that has happened between companies to its customers, is calculated from the value that is added and then subtracted from the whole purchase being made by the company at that time. Somehow, subtracting technique fails to account for a VAT for each of its sale. The company subtracts the whole purchase amount from the total sales and the final VAT rate is multiplied by it. On the contrary, by utilizing the credit invoice technique, the amount of the VAT of the company that must be paid on procurements will be excluded from the VAT because of the sales of the company. Because of this method, the VAT percentage is calculated for every single transaction and the sum of the VAT is then computed for the provided time. Although, the 2 methods appear to be the same, the outcomes are completely different.

Taking the previous notion into consideration, it is important to attribute whole credit of the tax that is spent on inputs without any part of the VAT chain breaking. This is since, it should be done at every production stage. The technique of addition is among the three techniques of computing the VAT obstacles to fulfill the task. This uses a formula which demands that the value added should be the same as the factor payments + the net profit. To identify the value being added, the company will add the costs for all elements of the value that was selected – the net profit, the payments, rents and loans. The result of the VAT is multiplied into the VAT rate. Through this method, there is an obstacle created for SME's (Small Medium Enterprises) which is regarding compliance (Ainsworth, 2006).

The contrast between the RST (Retail Sales Tax) and the VAT, is that supposing the total forward-shifting of both the RST and the VAT usually seem as though the same incase the entire goods & services taxes are taken at the same amount i.e., the revenue of the government is levied, the RST and the VAT would be the same rate. The only way that the VAT can levy the tax is by collecting it at all the levels once at a time. Alongside, the RST levies the tax at the last stage instead of each level, which literally translates to it being collected directly from the purchase made by the customer. Due to this dimension, the RST is cost-effective and more effectual than the VAT. On the other hand, VAT has many advantages over the RST system. One of the many perks of using the VAT is that it immediately distinguishes between the manufacturer and the customer, whereas, RST most of the time meet with issues regarding compliance (Ainsworth, 2007). RST is taken only from consumers at the end of the chain and not from the manufacturer, which makes an imbalance.

Producer goods is general name for the products that are not included in the RST. The underlying principle for removing them from the list of items to be taxed is, to circumvent paying taxes for one product repeatedly. Yet, RST allows producer goods to be taxed more. Compliance problems and administrative disturbances can arise from excluding producer goods such as these. Take for instance, a certain amount of producer goods would sometimes really be bought by customer (end-users). There must be a proper distinguishing done by tax designers, about what the producer goods initially are during the start of the regulation. On the contrary, VAT doesn't differentiate between the customers (end buyers), the manufacturers, and the sales. In fact, VAT immediately dispatches the collected amounts at all stages at the production chain. As a result, if RST is used, then even if at one stage there is a supposed failure to pay the tax, the government would lose the entire sum of tax. While with VAT, tax is levied at every stage and if at one stage, there is failure to pay the tax, a similar value will be appended at all the levels and each stage is responsible for their tax. Along with the invoice technique, this feature is regarded as a way in which VAT compliance is restored. Lastly, VAT enables services taxes to be taken more easily as compared to RST. Sometimes, it becomes hard for the tax administrators to levy the tax through RST while it's more efficient with VAT (Ainsworth, 2010).

The end stage, at which the VAT levies the tax, consists of different subsections, and the RST taxes and the tax payers must decide whether the tax shall be collected at each stage or it shall be collected as subjected to RST. RST doesn't pay attention to this problem by excluding tax-exemption for manufactures. While, the VAT takes a tax at all levels, one by one, while cancelling the huge impacts, and doesn't need any service providers or tax administrators to understand the cause of a service being purchased. This feature has an advantage in countries that drive their economy on service-based businesses.

6. DISCUSSIONS

A strong effort is being made by UAE to enact the VAT system though they had played along with enforcing VAT. Somehow, the prices of oil were falling from USD 115 per barrel the previous year to not more than USD 50 in the present day. All the GCC countries and even the UAE are in search of substitutes for revenue resources to lighten the burden on the budget of the state. The one valid choice for them to enact the VAT, is through GAT, which is also known as goods and services tax. The MOF (Ministry of Finance) in mid-August established that they were studying and researching on the application of VAT, with the help of GCC countries (Babbie, 2003). This was taken up to base on a contract made earlier that involved the GCC and UAE to enforce the VAT tax system at the same time. After the (IMF) International Monetary Fund's update on the financial condition of UAE, the MOF stated that there must be additional taxes taken to help the uncertain condition of the oil prices. As proposed by IMF that the VAT taxation should be 5% in the UAE. UAE had become the first ever country to relax the fuel rates after the 1st of August (Ainsworth, 2011). UAE successfully cut off the subsidies and align the prices of fuel with that of the global prices. This initiative

enabled the cost of petrol to hike up to 24% on an average. The move was risky but seen as worth it. Rest of the GCC members is anticipated to do what UAE had done to revive the cost of petrol.

6.1. Business Costs

Businesses are the ones being impacted the most by the new VAT implemented, because of the tax becomes an additional problem for them as to meeting with compliance strategies.

The financial services sector, including insurance, can be complicated with respect to the taxes, Ms. Kasi said. "More generally, and in common with any other business that becomes subject to VAT, there will be an additional cost and time needed to administer the VAT process. In relation to that, staff may need to be trained, and there may be a need for extra personnel to maintain a new level of bureaucracy." The insurance sector and the financial service sector claimed that the system can be complex. In her own words, Ms. Kasi stated that, "More generally, and in common with any other business that becomes subject to Vat, there will be an additional cost and time needed to administer the VAT process. In relation to that, the staff may need to be trained, and there may be a need for extra personnel to maintain a new level of bureaucracy."

Ms. Kasi also stated that, the prices after implementing VAT will comprise of the cost of the tax, and the price of abiding with filing the VAT and return policies, and the affect it may have on the cash flow of the businesses. The new taxes that were brought in, at least led the companies to making the best decisions possible. The impact of VAT was also seen on IT, where the accounting departments will have to be upgraded to manage the collection of tax (Bird and Gendron, 2006). The other issue that may arise if VAT is implemented concerns documentation. Mr. Sexton explained: "When VAT is introduced, it normally has special rules dealing with the requirements for invoices. Even if insurance services are VAT-exempt, it is still possible that special invoice requirements will be imposed." Ms. Kasi commented that, "Companies providing related to services, such as valuation services and claims-handling services, may also be impacted. Finally, companies providing guarantees, warranties or extended warranties on products should review the impact of any VAT treatment on their business model." This shows that, there is a certain attention being shifted towards the stance of the VAT in companies whose interest's mainly layout of insurance services but function for claim services, valuation services etc (Andrews, 1974).

6.2. Finding a Balance

The cost of oil and petrol remained low for a long period of time that directly posed a threat to the revenue of UAE. The situation was called a 'global glut of oil' by Goldman Sachs in one of his reports. This report also indicated a price fall low as USD 20 per barrel. There were already warnings come from IMF that told UAE that they should expect 2.3% fall in their budget in GDP in the year 2009. Therefore, there was a continuous fall in the cost of oil, and implementing VAT appears to be the best choice to bring back the revenue of the country and would be the most practical answer to the governing body. Ms. Kasi states that, the VAT compliance techniques that are being implemented will help the companies to obey the tax rules. There should be an appropriate thought given towards VAT credit system and their availability. The input of the credit should be availed to get the inter-GCC requirements and transactions (Baer et al., 1996).

7. CONCLUSIONS

The UAE was known for its tax-free policies around the world, but due to the changes oil prices the Kingdom has decided to bring in the tax policies like any other country. The kingdom is focusing on drawing more attention of foreign investments to increase more off-shoring and outsourcing from other countries. These plans clearly signify that the UAE plans to move ahead in its development. It has been giving its people an abundant living for many years, but now the kingdom seeks to focus on growth, which will also improve

the quality of public services provided by the government, not only in the present but also in the future and coming days. Support will also be provided to the government of UAE to go ahead to pursue their plans to make them more independent of revenue from their oil and petroleum sources. They in short, have made plans to set themselves free from their traditional sources of income and to move swiftly towards growth thus introducing VAT. But including VAT is not as easy as it sounds as there are several complications that can arise for example the tax fraud being one of them, which the government needs to be very mindful of. Hence, the government should be mindful of the studies that point out to certain techniques that can reduce the risk of people avoiding tax. Erbil points out that there are three types of techniques that can help in reducing tax fraud there are Addition, Subtraction and Invoice Credit (Bird, 2005).

As per several studies the impact is expected to be the highest on business organizations, because now business organization will have another added expenditure to the business firm. As pointed out by Ms. Kasi that it is going to be common for all business that becomes subject to VAT, there will be an additional cost and time needed to administer the VAT process. In relation to that, staff may need to be trained, and there may be a need for extra personnel to maintain a new level of bureaucracy.” The insurance sector and the financial service sector claimed that the system can be complex. In her own words, Ms. Kasi stated that, “More generally, and in common with any other business that becomes subject to Vat, there will be an additional cost and time needed to administer the VAT process. Though, the VAT will benefit the government and as it will help the government to be financially sound even after the dipping rates of oil, but the impact would be felt on an individual and business level, which can lead to unsatisfactory opinions that can lead to tax fraud, thus making the implementation rather complex (Economist, 2006).

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