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VAT AND ACCOUNTING ISSUES AND SOLUTIONS IN UAE

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ABSTRACT

Earlier the implementation of the VAT in UAE was the plan but now has become the reality in UAE. Most of the countries have the system of VAT or GST in accordance with the law of that country. In the initial stages these countries have also faced the challenges and have been solved easily. This article for the publication has been given for providing the overview of VAT and accounting issues that company and the firms will face in UAE. Along with defining the issues, the solution thereon has also been explained. It will help the businesses to implement the VAT successfully and manage the VAT related issues even after the implementation. There will be plethora of issues that the businesses will face in VAT registration. Detail has been given as to which approach of accounting shall be used for making the accounting entries under VAT. With these considerations the article is being presented and hopes it will be useful for the readers and users.

1. INTRODUCTION

The government of every country lays down every year new policies and procedures to equip the public with the new technologies and advancements in every respect. It may be either related to the new schemes such as for setting up the cold chain project the government provides the subsidy, similarly the government provides aid for the setting up of the hospital or the college. In the similar manner, it is duty of the government to bring about the changes in the tax regime of the country. It is because the financial structure of the economy needs update with the increase or decrease in the standard of living of the economy. This financial structure is relating to the income of the residents and which in turn are required to be updated with the changes in the tax regime.

In this article the VAT implementation in UAE, one of the member country of GCC has been discussed in detail. The article has provided the overview of the how the system of VAT will work, how the tax will be charged and how it will be Calculated, how the returns are required to be filed and most importantly how the accounting will be made in the accounting software of the company, etc. The implementation of the system of VAT in the GCC will impact all the businesses of the country and on all parts of the business. Every kind of implementation requires the significant time to make their people, suppliers, employees etc. prepared for the change. The support of the top management of the company will always be required for its successful implementation.

The implementation of the VAT shall be well designed and planned for having the system of ongoing compliance and low risks.

We will be happy to hear about the article and the topic at any point of time. For any type of Queries, you may write to us or email us. With these considerations, the article has been written and presented in appropriate and sufficient headings.

2. DESIGN METHODOLOGY / APPROACH

The methodology that the country has adopted is like the VAT prevailing in other countries. The following are the reasons for the similarities:

- Definition of the Supplies is similar and there is no use of the words sale and purchase separately as done under the old VAT regime.
- The accounting treatment along with the consideration of each item of the purchase and sale is similar
- The name given to the tax on purchase and tax on sale is similar.
- The frequency of filing of the returns is same. It may be monthly and quarterly.
- The frequency of making the payments of tax is similar.

Methodology or approach is concerned with defining how the task has been done. It is very necessary to have the detailed methodology and approach to understand both the positive and negative side of the approaches and which further help the company to adopt such approaches in the system of the businesses.

Before proceeding with the approach that the FTA has adopted for the implementation of the VAT in UAE, it is necessary to understand as what the meaning of VAT is and how it will work in the economy of the UAE, before whom the businesses and the SME's thereon will get registered under VAT, what are the requirements for getting the registration under VAT, what type of documents are required to be attached file obtaining the registration under the new regime of VAT, what are the deadlines if any mentioned for obtaining the registration under VAT regime for the different classes of businesses, what will be the periodicity of depositing the tax before FTA, what will be the periodicity of the filing of the Returns under VAT regime, what will be the threshold limit if any for getting the registration under the VAT and so on. Therefore, these details shall be understood first (Ahmad and Brosio, 2010).

At first the meaning of VAT shall be discussed. Vat is the tax which is indirectly paid to the credit of the Government after receiving from the customer. VAT will not only apply of the domestic dealing but also shall apply in case there is the exportation of goods. It is defined as the Value addition tax which means that the tax shall be charged at every point of time where there has been creation in terms of the value has been done. In other words, if the value is added to the goods either in monetary terms or in terms of the quality, the tax will be charged on the total value of the product (Ainsworth and Alwohaibi, 2016). It will be explained in detail with the help of the very small example. For instance, Mr. A, being the supplier send the goods to factory at AED 1000 plus the VAT of AED 50. This AED 50 will be received by the supplier from the factory and will be paid by the supplier to the credit of the government and factory will receive the benefit in terms of the credit available due to filing of account. Then the factory manufactures the product with the help of labor and machines. This manufacturing has added the value to the product and accordingly the factory now sells the product to wholesaler at AED 2000 plus the VAT of AED 100. Now the factory will deposit the tax of AED 50 in net to the government authorities because the tax amount already paid to the supplier will be available as the credit to the factory and will be subtracted from the tax received from the wholesaler. Continuing with the same example if now the wholesaler makes some addition for instance added the brand as per the requirement of the retailer, then the wholesaler will add the value and then charge the VAT amount. Now the wholesaler charges AED 3000 plus VAT of AED 150 and sell the goods to retailer. Now the wholesaler will deposit the amount of AED 50 with the government as the difference between the charged amount and the tax paid on the purchases. The retailer then will make the additions either by repacking the same or by changing the packing and so on and sells the goods to the end consumer. The retailer charged $5000 plus AED

$250. The retailers will have the credit of the earlier credit amounting to AED 50 and thus, the retailer is required to make payment of the AED 100 and at this point of time the value-added chain gets break. In this example Vat shall be applicable for 5% accordingly the figures have been arrived. Thus, the VAT regime consists of the fact that the value is required to be added at every stage of production till it reaches the end consumer and with that creation of the value to the products, the credit of the inputs or inputs services are used, and the payment is made in net of the tax charged. It has been mentioned that VAT will be applicable on every type of goods and services and there are exceptions to this also (Kneller and Misch, 2017). The exceptions include items of food, medicines, zero rated supplies whereby there is either exportation of goods or services provided internationally, healthcare products and services, education and sale or lease of the property.

The tax credit that the factory, wholesaler and the retailer has received is known by the name of the Input Tax Credit and the tax that is being charged from the next party and thus receives is known by the name of the Output Tax.

VAT to be paid equals to the Output VAT charged from the next party less the Input VAT credit.

The design starts from the definition of the authority that has the power to control and manage the affairs of the VAT implementation, function and management thereon. The authority is known by the name of FTA which means Federal Taxation Authority. It has laid down the threshold limits for the registration under VAT laws and the procedures for filing the VAT returns and the payment of Tax. For the registration under the VAT laws, following have been enacted and it is mentioned as:

- At first the FTA has divided the supplies into three sections. One is taxable supplies, second one is Zero Rate Supplies and the third one is Exempt supplies/. First supplies include the supplies of goods and services for the consideration and on which the tax is levied. Second is the supplies on which the government's tax will never be due and third supplies includes those goods or services for which the rate of zero has been undertaken.
- The threshold limit for the turnover has been the AED 375000. It is mentioned that any businesses with expected or actual turnover of more than AED 375000 shall be liable to get it registered under the VAT laws. The non-compliant of this provision will lead to the penalty of AED 20000 (Whitehouse and Nurmi, 2016).
- Along with defining the threshold limit the law has also provided the deadline as to by how much time the businesses are required to get themselves register under the VAT laws. First deadline mentions that UAE tax residents with the turnover of greater than AED 150 million shall apply for the registration under Vat by 31st of October 2017, UAE tax residents with the turnover of greater than AED 10 million shall apply for the registration under Vat by 30th of November 2017 and UAE tax residents which will reach the position under the mandatory registration, then the businesses shall apply for the registration on or before 4th of December 2017. These deadlines have been included in the system only to ensure that all the businesses of the UAE have been registered in time.
- The registration portal is available on the portal of the FTA website. It requires some list of documents including the Tax Payer Identification number and address proof of the business, etc.
- VAT has been proposed and will be made applicable from the1st of January 2018 and all the accounting treatment thereon will change accordingly. The accounting treatment has been the major issue of concern dealing with the GST scenario. It is because with the implementation of the VAT the act of treatment of purchases and sales will differ with respect to the accounting and the presentation thereon. It means when we account for the purchases, the amount in front of purchases shall be equal to the gross value of purchases excluding the VAT amount and in sales also the VAT amount is excluded. It means the Vat amount both sale and purchase will be transferred under the head of the duties and taxes wherein there will be the proper division of the VAT amount on purchase as well as the VAT amount on sales. The VAT

amount on purchase is termed as the Input VAT Credit and the VAT amount on sales is termed as the Output VAT payable.

For instance, If ABC purchases the goods worth of AED 10000 from XYZ. 5% VAT is applicable on it. The purchase accounting entry will be:

Purchase Account Dr 10000

Input VAT Dr 500

To XYZ 10500

Similarly, for sales accounting will be done. If ABC sells the goods to MNO for $20000, 5% VAT is applicable on it. The sale accounting entry will be:

MNO Dr 20000

To Output VAT 1000

To ABC 19000

- At the end of every month there will be either the balance in the input credit account or the output payable account. If there is the balance in the input credit account, then it is meant that there will be no liability of paying the tax rather there will be tax with the Government for your account. If there is the balance in the Output credit account, then the amount of VAT will be regarded as the amount payable and is required to be paid before filing of the return. It is because the return cannot be filed without the payment of the tax (Thacker, 2012).
- Second major issue is in the accounting treatment of the VAT in case of the manufacturing operations. It is because under the manufacturing operation there will be difficult to relate the input VAT with each value addition made within the factory of the business. It is because there might be the case where the goods are sent from one department to another and then cost is found out.
- VAT system works on the self-assessment procedure wherein the tax payer is liable to calculate the tax liability on his own with the proper calculation of the sale and purchase and checking them with the books of accounts of the company.
- Along with the self-assessment procedure the Act has also laid down the types of records that every registered person shall prepare. First is sale invoice with correct serial number. Similar for debit and credit notes. Third is the record of import and export made and last are the accounting books which will include the sale ledger, purchase ledger, input and output vat ledger (Mears, 2016).
- The approach that the FTA has adopted is in accordance with the work done by the other countries. In accordance with the size of the economy the methods and approach adopted by the FTA is adequate. The FTA portal has been working well and not received any complaints regarding the registration under VAT rather the businesses have find it very user friendly.
- At the time of the implementation of the VAT, the businesses are required to implement the system whereby the current processes can be modified and altered to adopt the new Information Technology system on which the entries in accounting can be made. The system shall be well equipped with the updated software like Tally ERP 9. It is because with the updated software and upgraded technologies there will be the less chances of having riskiness in accounting. It is very necessary to have the clear and precise accounting. It is because of the reason that it is the accounting work only through which the base of VAT return will be developed. If the data is not correct then it shall serve nil purpose as the VAT return will not be filed (Poddar and Kalita, 2010).

In this manner, the design and the approach has been considered in this article.

3. FINDINGS

After understanding the design and the approaches that have been adopted for implementing the VAT in UAE, there is the need of understanding the findings through the VAT laws and discussion that is being implemented. Following are the findings from the study:

- **Need of Updated Software** – Currently businesses in UAE does not have any kind of tax due to which the companies and the firms have adopted the general accounting and other software which can be used in either conditions whether the company is manufacturing or trading or service provider (Karen, 2010). But with the implementation of VAT in UAE, it is very important to have such an information technology system which can cope up with the changes in the external environment including the changes in VAT laws and rules there under. VAT has the implication on the overall functions of the business, whether it is purchase, whether it is sale or etc. major finding in this area is to either employ the new system like Tally ERP 9 or else shall modify their current systems and the processes to make all the required reports available at any point of time. In case the current system is being modified or altered then it is must be ensured that the processes and transactions are not being hampered on testing rather it shall be kept as safe (Haines, 2016). It must be checked that VAT shall be mapped according to the nature of processes and business functions of the organization. It must also be checked that whenever any authority comes either for the inspection or for the audit, the document relating to VAT shall be immediately given and other reports as required by such authorities (Zafarullah, 2018).
- **Ongoing Compliance and Review** – The second major finding out of the design and the approaches of the VAT implementation is that the VAT system is required to be checked for compliance on the daily basis or the regular basis. It is because sometimes due to non-review on the timely basis there comes an error and the report thereon of the VAT calculation and the sale and purchase reconciliation comes wrong or the change in rate of the item does not reflects in the system. Thus, there is the close need of having the continuous review to ensure that the company is in compliant with the requirements of the VAT laws and regulations and that too on the timely basis (Azzam and Rettab, 2015).
- **Use of External Advisors** – With the implementation of the VAT and due to the presence of various issues under the VAT accounting and returns compliances and majorly due to complexity in operating the FTA portal, most of the businesses will look for the advisors who will be external to the company. These advisors will guide the company as well as the concerned official as to how the VAT issues shall be resolved and accounting shall be done. Due to this the compliance part will be outsourced.

Thus, in this manner, the findings or the observations have been listed from the VAT design and methodology.

4. RESEARCH LIMITATIONS / IMPLICATIONS

With the understanding of the design and methodology issues and checking the findings of the company, there shall be discussed which will be relevant for this article is the limitation that has been faced while conducting the research and the implication that the research will have on the VAT accounting issues.

- JAFZ / DAFZ – As per Article number 51 (1) of the UAE cabinet resolution number 52 issued in the year of 2017, some zones are there which will be regarded as free zones and on that the VAT regime will not be made applicable. These free zones are the zones which remain outside the territory of the UAE to ensure the presence of the effective broader control (Stanley-Smith, 2015). These free zones are exempted from the application of the regime of VAT. The main limitation that has been observed is that the government has been failed to specify as to which free zones or the designated zones will be exempt and satisfy the conditions as laid down under the article 51(1). No clear distinction has been made as regard to which are the free zones, and which is not the free zone. As per the UAE law, JAFZ and DAFZ have been regarded as the free zones and are exempt from the VAT. The decisive factor for determining the free zones is the operation of the activities beyond the fences (Ahmad, 2010). The free zones are the fenced free zones. The limitation is that the free zones have been classified based on their location from the fences.

- Contracts – The second and major limitation is the entering into contract with other parties before the implementation of the VAT. It is said that if the contract is entered with the other business party and that too before the implementation of the VAT then there is the double opinion that either the price so decided and discussed will be inclusive of VAT or exclusive of VAT. Therefore, before entering into the contract before the implementation of VAT, there should be clear and concise disclosure in the contract about the VAT rate and price. The law of UAE states that if the contracts that have been entered earlier before the implementation of the VAT, then it shall be treated as the mount of contract which is VAT exclusive (Almutairi, 2014). This condition will prevail if:
    - If the customer involved in the contract is the registered business
    - If the customer so concerned can take the benefit of the VAT charged as input VAT and
    - If the supplier takes the confirmation from the customer regarding the two points.

  The price shall be VAT inclusive if and only if:
    - The goods and services under question are exempt from VAT or subject to the VAT.
    - The customers involved in the contract are not registered person under VAT Regime.
- No data Available – The major limitation is that the government portal of UAE which is FTA does not provide the data relating to the customers who are registered in VAT due to which the entry to the contract and determining the price thereon will always be in the confusing stage. The contract price will not be determined as whether it is inclusive of VAT or exclusive of VAT (Gurrib, 2017).

Thus, the above are the limitations found during the research of the topic and the implications thereon.

5. ORIGINALITY/VALUE

After analyzing the limitations that has been faced during the research and implication thereon, it is to be analyzed whether the VAT regime as implemented in UAE is original or not. The work of the VAT regime in UAE is not original but it has been copied from other countries.

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