VAT and Doing Business
Outside the Scope of Commercial Licenses in the UAE

*The introduction of VAT in the United Arab Emirates ("**UAE**") on 1 January 2018 is undoubtedly one the biggest exercises for both the governmental and the private sector. While major aspects of the implementation remain unclear (e.g. VAT refund process and duration), one related issue has, so far, not been in the focus of many companies: Through the introduction of VAT, taxable supplies need to be invoiced for tax purposes. By invoicing such transactions, one may document their incompliance with UAE law. The purpose of this newsletter is to give an overview of the legal implications of acting outside the scope existing commercial licenses under the new VAT regime.*

1. *What is the issue?*

Experience shows that investors, either having set-up their operation in UAE mainland or in free zones, often carry out (adjacent) services which may not be covered by their respective commercial license.

Example:

> *A company located in one of the UAE free zones exports system components to its costumer in the UAE mainland. The company holds a trading license only. Apart from the supply, the costumer requires the company to render training services onsite in the UAE mainland.*

2. *How does VAT affect operations which are not covered by my license?*

Before the introduction of VAT, economic operators were only issuing so-called commercial invoices. Now, with the introduction of VAT, depending on the nature of supply, for such transaction a tax invoice may have to be issued. Such tax invoice must contain a certain minimum of information, e.g. the following:

- details of supplier and customer;
- tax registration number of supplier and customer;
- description of goods and/or services; and
- gross amount and tax amount

In the example, the following would apply:

> *For the supply of services in the UAE mainland, the company located in the free zone would need to issue a tax invoice, including the statutory content.*
>
> *For VAT purposes the place of supply of the services would be considered being in the UAE mainland. Based on that, the services would be considered a taxable supply, henceforth making it necessary to issue a tax invoice.*

3. *How does the VAT invoice relate to my operations? What are the consequences of acting outside of the scope of a license?*

The VAT invoice does not have any negative implications on the business per se. However, by issuing tax invoices and filing them accordingly, the company is documenting its breach of law since – in addition to the trading activity which it is licensed for – the company is providing unlicensed service activities. On the one hand, the tax invoice will contain the subject of tax (in the example: services in the UAE mainland). On the other hand, such invoices will need to be submitted for the purposes of VAT filing and stored for record keeping.

While the Federal Tax Authority ("**FTA**") is not competent to pursue any non-compliance with commercial law, it is expected that the FTA and other relevant authorities (*e.g. Ministry of Economy, Department of Economic Development/Dubai Economy, Free Zone Authorities etc.*) will exchange information.

It should be noted that it is not a question, whether such information exchange will be implemented but rather when and to what extent.

If the relevant authority notices that a company is acting outside of the scope of a license, the investor may be fined, and/or the license may be suspended and/or revoked. Such processes are rather informal, and the determination of any measures is up to the sole discretion of the respective authority. It should be kept in mind that more than one authority may be competent to sanction investors in such case (*e.g. the Free Zone Authority and Department of Economic Development/Dubai Economy*). In the worst-case scenario, the investor will, therefore, face fines and/or suspending orders from multiple authorities. This will add additional complexity to resolving such issue.

4. *What is the solution, what are the obstacles?*

Taking into consideration the above, investors should review their actual business activities against the background of their existing licenses. Any deviating activities should be discontinued until such activities are covered by a respective license. This makes it necessary, that an investor's set-up in the UAE may need to be reviewed in total.

In the example, the following would apply:

> *The free zone entity (or the parent company) can carry out such activities in UAE mainland subject to respective licensing requirements/restrictions. The costs of such application and adjacent costs (e.g. renting of office space, employing staff etc.) would need to be assessed on a case-by-case basis and compared to the expected revenue of such an additional entity.*

5. *Conclusion*

One of the major implications of the introduction of VAT is that in order to comply with VAT requirements, investors acting outside the scope of their licences will document such violation of applicable law.

Based on that, investors should keep in mind the following:

- Investors should be aware of the documentation implication of issuing VAT invoices;
- They should carry out an inventory of their business activities and scrutinize whether such activities are covered by their license; and
- In case, activities have been identified that are not covered by a license, such activities should be discontinued, and the set-up would need to be adjusted accordingly.

As can be seen from the above, VAT will, therefore, not only have an implication on the cost of doing business (*e.g. by implementing the VAT*) and cash-flow, but it will cause a de facto control mechanism with regard to license requirements. It is advisable to approach this change in the regulatory landscape proactively.

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