

## VAT – Practical VAT Considerations regarding Designated Zones in the UAE

*The United Arab Emirates and the Kingdom of Saudi Arabia were the only GCC states that have implemented Value Added Tax (VAT) with effect of 1 January 2018 as per the Unified GCC VAT Agreement from December 2015. The Implementation of VAT has been especially challenging in the UAE with regard to the treatment of free zones, some of which - so-called Designated Zones - are subject to special rules. This briefing gives an overview of practical cases of VAT application in Designated Zones.*

### **A. Introduction / Legal Framework**

While the legal framework for implementing VAT in the UAE has been gradually prepared for the past one and a half years, the relevant provisions regarding its application in free zones were only published in December 2017 (the Executive Regulations on VAT Law, Cabinet Decision 52/2017, “ER”) and January 2018 (Cabinet Decision 59/2017 on Designated Zones) both of which came into effect on 1 January 2018. The following timeline shows the sequence of implementation of relevant tax legislation:

<b>December 2015</b>	Signing of Unified GCC VAT Agreement
<b>September 2016</b>	Federal Decree Law No. 13/2016 on the Establishment of the Federal Tax Authority
<b>June 2017</b>	Federal Law No. 7/2017 on Tax Procedure
<b>August 2017</b>	Federal Decree Law No. 8/2017 on Value Added Tax (“VAT Law”)
<b>September 2017</b>	Cabinet Decision No. 36/2017 on the Executive Regulations on Tax Procedures
<b>December 2017</b>	Cabinet Decision No. 52/2017 on the Executive Regulations on Value Added Tax Law
<b>01 January 2018</b>	<b>Full implementation of VAT</b>
<b>January 2018</b> (issued in December 2017 but published in January 2018)	Cabinet Decision No. 56/2017 on Medications and Medical Equipment Subject to Tax at Zero Rate
<b>January 2018</b> (issued in December 2017 but published on 10 January 2018)	Cabinet Decision No. 59/2017 on Designated Zones in the UAE

As a general rule, free zone companies are not excluded from the application of VAT in the UAE. However, certain specific rules apply if a free zone is classified as a Designated Zone. Prerequisites in order for free zones to be classified accordingly are a fenced geographical area with security measures and customs controls to monitor entry and exit of individuals and goods.

Since the Cabinet Decision 59/2017 on Designated Zones was only published on 11 January 2018, free zone companies registered in Designated Zones were facing a situation where VAT had already been introduced while the details with regard to its application in Designated Zones were unclear. This has now been clarified. Cabinet Decision 59/2017 declares the following free zones as Designated Zones:

<b>Emirate</b>	<b>Designated Zone</b>
Abu Dhabi	<ul style="list-style-type: none"><li>• Free Trade Zone of Khalifa Port</li><li>• Abu Dhabi Airport Free Zone</li><li>• Khalifa Industrial Zone</li></ul>

Dubai	<ul style="list-style-type: none"> <li>• Jebel Ali Free Zone (North-South)</li> <li>• Dubai Cars and Automotive Zone (DUCAMZ) Dubai Textile City Free Zone Area in Al Quoz</li> <li>• Free Zone Area in Al Qusais</li> <li>• Dubai Aviation City</li> <li>• Dubai Airport Free Zone</li> </ul>
Sharjah	<ul style="list-style-type: none"> <li>• Hamriyah Free Zone</li> <li>• Sharjah Airport International Free Zone</li> </ul>
Ajman	<ul style="list-style-type: none"> <li>• Ajman Free Zone</li> </ul>
Umm Al Quwain	<ul style="list-style-type: none"> <li>• Umm Al Quwain Free Trade Zone in Ahmed Bin Rashid Port</li> <li>• Umm Al Quwain Free Trade Zone on Sheikh Mohammed Bin Zayed Road</li> </ul>
Ras Al Khaimah	<ul style="list-style-type: none"> <li>• RAK Free Trade Zone</li> <li>• RAK Maritime City Free Zone</li> <li>• RAK Airport Free Zone</li> </ul>
Fujairah	<ul style="list-style-type: none"> <li>• Fujairah Free Zone</li> <li>• FOIZ (Fujairah Oil Industry Zone)</li> </ul>

It is important to understand that free zone companies are treated as “regular” mainland companies unless the respective free zone has been qualified as a so-called Designated Zone. Furthermore, it should be noted that a **registration with the Federal Tax Authority** is required (if the company reaches the respective turnover thresholds), irrespective of whether the company is in a free zone or Designated Zone. The main principles applied to Designated Zones are as follows:

In general, a Designated Zone will be considered as being outside the UAE (Article 51 para. 1 Cabinet Decision No. 52/2017). Therefore, specific rules apply when **goods** are **transferred between Designated Zones**. Those rules follow the Customs rules and require a financial guarantee to be given (Article 51 para. 3). On goods transferred from one Designated Zone to another Designated Zone no VAT is applicable.

Furthermore, when assessing VAT implications on Designated Zones, it is **crucial to distinguish between goods and services**.

If **services** are being rendered within a Designated Zone, standard VAT rate has to be applied – irrespective of the recipient (individual or company, Article 51 para. 6) The same applies if a free zone entity registered in a Designated Zone renders services in the mainland (whereby limitations of free zone licenses should, of course, be observed).

If **goods** are sold from an entity registered in a Designated Zone, three different cases have to be distinguished:

- a. No VAT is applicable if a good is sold to another company registered in a Designated Zone since the territory of the Designated Zone is considered as being outside the UAE (Art. 51 para. 1 – see above).
- b. If goods are sold from an entity registered in a Designated Zone to an individual, VAT is applicable.

- c. If goods are sold from an entity registered in a Designated Zone to a company registered in the mainland, VAT is applicable, however, the buyer is liable to account for VAT (reverse-charge-mechanism).

## B. Cases

Input VAT Cases: Supply <u>to</u> Designated Zone Company	Supply of	
	Goods	Services
	to Designated Zone Company	
by Mainland Company	<ul style="list-style-type: none"> <li>Mainland company will charge VAT</li> <li>Company in Designated Zone can forward the VAT to customer if registered</li> </ul>	
by Designated Zone Company	no VAT charged	VAT charged
by Foreign Company		VAT to be accounted for by Designated Zone company ( <i>reverse-charge-mechanism</i> )

Output VAT Cases: Supply <u>by</u> Designated Zone Company	Supply of	
	Goods	Services
	by Designated Zone Company	
to Mainland Company	VAT charged; mainland company accounts for VAT ( <i>reverse-charge mechanism</i> ) if the mainland company is the importer of record	VAT charged
to Designated Zone Company	no VAT charged	
to Foreign Company	no VAT charged	

## C. Conclusion

While the Cabinet Decisions 52/2017 and 59/2017 have finally clarified some major questions surrounding the application of VAT in free zones and especially in Designated Zones, some details remain open to interpretation. For example, it is not clear how cases of mixed supply of goods and services will be treated. This will likely depend on the application of said Cabinet Decisions by the Federal Tax Authority.

Companies registered in a Designated Zone and companies and individuals dealing with Designated Zone-companies should be aware of the details with regard to supplies (whether of services or goods) made by or to companies in Designated Zones. As is often the case with legal and tax matters, seemingly small distinctions can have a big impact on the end result.

## Contact

**SCHLÜTER GRAF Legal Consultants**

Dubai / UAE

The Citadel Tower

Offices 2001-2005

Business Bay

P.O. Box 29337

Tel.: +971 / 4 / 431 3060

Fax: +971 / 4 / 431 3050

**Andrés Ring** ([andres.ring@schlueter-graf.com](mailto:andres.ring@schlueter-graf.com))

**Yulia Kasiyanova** ([yulia.kasiyanova@schlueter-graf.com](mailto:yulia.kasiyanova@schlueter-graf.com))

**Dr. Constantin Frank-Fahle** ([frank-fahle@schlueter-graf.com](mailto:frank-fahle@schlueter-graf.com))