

UAE: VAT Guide on Designated Zones - VAT Guide (VATGDZ1)

August 2018

In brief

On 29 July 2018, the Federal Tax Authority (“FTA”) published a [VAT Guide](#) on Designated Zones - VAT Guide (VATGDZ1).

Guidance is provided on the specific characteristics of a Free Zone and how it can qualify as a Designated Zone for VAT purposes. Additionally, information and examples also detail the practical application of [Article 51 of the UAE VAT Executive Regulations](#) in order to help businesses operating in designated zones.

In detail

Qualification as a Designated Zone for VAT purposes

In order for an area located within one of the [Designated Zones](#) to qualify as being outside the UAE (for VAT purposes), it must also meet the criteria of [Article 51 of the Executive Regulations](#):

- It is a specific fenced geographic area; *and*
- It has security measures and Customs controls in place to monitor the entry and exit of individuals and movement of goods to and from the area; *and*
- It has internal procedures regarding the method of keeping, storing and processing of goods within the area; *and*

- The operator of the Designated Zone must comply with the procedures set out by the FTA.

It is only when the area within the Designated Zone meets all the requirements of Article 51 of the Executive Regulations should it be treated as outside the UAE territory for VAT purposes (applicable to specific supplies of goods only).

VAT obligations for businesses established within a Designated Zone

Businesses established within a Designated Zone are considered to be established ‘onshore’ (i.e. within the UAE) for VAT purposes. As a result, they have the same VAT compliance obligations and rights as non-Designated Zone businesses. They may

be required (or may decide voluntarily) to register, account for VAT, file VAT returns and pay VAT under the general VAT rules. They are also eligible to become a member of a VAT group together with other UAE businesses (provided all the conditions to form a VAT group are met).

They are also subject to the normal UAE rules for the input VAT recovery on their taxable expenses.

Application of VAT for the businesses trading in Designated Zones – Overview of the rules

The supply of services

Designated Zones are considered to be within the UAE territory for the purpose of performing and receiving services. Thus, designated zones are subject to the general provisions of

the [UAE VAT Law](#) and [Executive Regulations](#), including the obligation to account for VAT under the reverse-charge mechanism on imported taxable services.

The supply of goods and the concept of “consumption within a Designated Zone”

In general, the supply of goods within a Designated Zone should be considered as outside the scope of VAT. However, where the supply is “consumed” in the Designated Zone it will be deemed as within the UAE and subject to VAT. This rule will apply to:

- Buy and sale transactions (i.e. acquisitions of goods for their re-sale); *and*
- Goods supplied in order to be incorporated into, attached to, or otherwise form part of another good located in the same Designated Zone – provided that other good is not consumed in the Designated Zone; *and*
- Goods supplied to be used in the production of another good located in the Designated Zone – provided that good newly produced is not consumed in the Designated Zone.

This general rule is overridden where the supply of goods is made within a Designated Zone for “consumption”. In this case the supply will be considered as made within the UAE VAT territory and subject to the UAE VAT Law provisions.

As per the Guide, the term “consumed” should be interpreted broadly to include any utilisation, application, employment, deployment or exploitation of the goods.

The Guide provides few illustrative examples where goods will be considered “consumed” for VAT purposes.

Identification of the intended use of the goods acquired within a Designated Zone

The guide contains a very important practical update on the formal process surrounding supplies of goods within a Designated Zone.

For goods sold in a Designated Zone, it is normally the supplier’s responsibility to identify the intended use of the goods (i.e. “consumed” or not) so as to apply the correct VAT treatment. As a general rule, suppliers should not treat their supplies of goods within a Designated Zone as being outside the scope of UAE VAT unless they are satisfied that the goods are not going to be “consumed” by the purchaser in the Designated Zone.

In this respect, in order for the seller to not charge UAE VAT on the supply, the FTA has suggested that the purchaser provide a written statement detailing that the goods are not purchased to be “consumed” in the Designated Zone

Subsequent consumption or loss of goods within a Designated Zone

As per Article 51(8) of the UAE VAT Executive Regulations, where VAT has not been paid on the movement/acquisition of goods in a Designated Zone, the owners of these goods should monitor their status (i.e. ‘consumed’ in the designated zone, lost, shipped abroad, imported into UAE Mainland etc.) and report and pay import VAT if the conditions for a UAE VAT import have been triggered.

Transfers of goods into a Designated Zone

The Guide lists three scenarios for the transfer of goods into a Designated Zone with indicated treatment:

- Any movement or supply of goods into a Designated Zone from outside the UAE would be treated as taking place outside the UAE VAT territory.
- Any movement or supply of goods from ‘mainland’ UAE into a Designated Zone is not considered to be an export of goods for VAT. Therefore, such movements and supplies are treated as local movements / supplies and subject to UAE VAT where applicable.
- A transfer of goods (that is, either a sale or movement of own goods) between two Designated Zones will be treated as outside the scope of UAE VAT

subject to the fulfillment of two conditions: (i.) the goods, either in part or in their entirety, are not released into circulation, nor used or altered in any way during the transfer; and (ii.) the transfer is undertaken in accordance with the rules for Customs suspension per the GCC Common Customs Law.

For the last scenario, the FTA may require the owner of the goods to provide a financial guarantee for the payment of VAT.

Import of goods from a Designated Zone

The movement of goods from a Designated Zone into UAE 'mainland' is treated as an import of goods into the UAE for VAT purposes and import VAT becomes due by the importer of record (unless the goods are moved under a customs duty suspension arrangement).

The guide provides clarity on situations where a good can be subject to double VAT taxation. A double taxation will arise where a good was subject to VAT while acquired for "consumption" within a Designated Zone before being imported into the 'mainland' and subject to import VAT.

In this case, the VAT paid at import will always be fully recoverable, irrespective of the importer's usual input VAT recovery entitlement.

In order to fully recover the VAT upon import, the

importer will be required to retain evidence that VAT was incurred twice; in respect of the purchase in the Designated Zone and in respect of the import. The importer must also be able to substantiate that there were no intervening transactions between the purchase of the good and its actual import.

Any subsequent sales after import in the UAE will follow the UAE VAT rules.

The sale and subsequent importation of goods into the UAE from a Designated Zone may require VAT to be applied. The VAT treatment will depend on the date of supply (i.e. whether or not VAT was required to be applied when the goods were still in the Designated Zone or only after the importation).

Specific cases

Supply of water and energy

Where water or energy is supplied for consumption (e.g. water and electricity provided by a water and electricity authority), then the place of supply of such water and energy is within the UAE and the supply is subject to the normal VAT treatment. This principle applies even if the water or energy is used in the process of production of other goods in the Designated Zone. Suppliers of water and energy shall charge VAT without the need to distinguish between the potential uses for water and energy.

The supply of energy, in the form of oil, gas, and other similar goods in order to be

traded (buy and sell) by businesses within Designated Zones, may still be treated as happening outside the UAE VAT territory if all the necessary conditions attached to Designated Zones are met.

Supply of real estate

The supply of real estate (sale or lease) located in a Designated Zone are considered outside the UAE VAT territory and not subject to UAE VAT.

The raw material purchased within a Designated Zone for the purpose of constructing a real estate in the Designated Zone will also be treated as outside the UAE VAT territory and not subject to UAE VAT.

Any other supply of real-estate related services (the grant of a license to occupy, hotel accommodation, etc.) will be considered a supply of services and subject to UAE VAT rules where supplied in a Designated Zone.

Tax groups (VAT groups) & Branches

Where a supply of goods between VAT group members results in goods being moved from a Designated Zone to the UAE mainland, it will be considered an importation of goods and trigger the obligation to pay VAT on the import.

The same rule applies where an entity moves its own goods from a Designated Zone into the mainland UAE (e.g. when transferring the goods from the branch in the Designated Zone to the

head office in UAE mainland).

For VAT Groups or VAT registered entities, the

payment of VAT at import may be deferred to the submission of the VAT return. In other cases, import VAT will have to be

paid before the goods are released from the Designated Zone.

The takeaway

This Guide provides clarity and practical guidance on a broad range of transactions happening in Designated Zones:

- For supplies of goods happening in a Designated Zone, it is critical that the supplier confirms the purchaser's intended use of the goods and retains evidence of it. The practical solution offered by the FTA in this respect (i.e. purchaser's written statement) is very welcome.
- The FTA's interpretation of goods "consumed" in the Designated Zone is broad and includes any utilisation, application, employment, deployment or exploitation of a good in the Designated Zone. As such, it is recommended that businesses review the position of their arrangements from a VAT perspective where they may have applied a strict definition of the word "consumption".
- The Guide also clarifies the cases where a double VAT taxation can arise (due to a good acquired in a Designated Zone and further imported into UAE "mainland") and the necessary steps to eliminate this double taxation.

Given the complexity of the VAT rules surrounding transactions in Designated Zones, businesses are recommended to review their VAT position in the light of this Guide.

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