



VAT Public Clarifications – 1st Edition

Introduction

Pursuant to the User Guide issued in April 2018 on the facility to obtain clarifications on specific matters of uncertainty and obtain written guidance or advice, the FTA has recently issued the first set of public clarifications (VATP001 & VATP002) on its e-services tax portal.

In this alert, we have summarised key aspects of these public clarifications:

VAT Treatment on Compensation Type Payments (VATP001)

Issue	Whether VAT is applicable on payments made as a part of business arrangements to compensate for any loss, omissions or other wrong doings by businesses.
FTA Clarification	<ul style="list-style-type: none"> • No VAT is due on payments which are not a consideration for supply. • Whether payment is consideration of supply is a matter of fact and dependent on the underlying arrangement. • It is necessary to consider the contractual and legal arrangement in order to determine whether a payment is consideration for any supply. • Ignore labels or titles tagged to the payment. Description of payment as 'penalty' or 'compensation' will not prevent the nature of payment from being consideration for supply.



Illustrative list of transactions provided by FTA as guiding principles to determine VAT impact:

01

Compensation for loss

Outside VAT Scope: Pre-determined amount paid as compensation upon specific breach e.g. liquidated damages, early termination or late performance

Taxable: Charges levied for cessation of right under contract cancellation, e.g. cancellation of a Hotel booking

02

Payment for settlement of dispute

Outside VAT Scope: Payment towards damages or compensation loss without supply, e.g. payment for loss of earnings or interest on delayed payment

Taxable: Payment to

- Enforce contractual term, e.g. dispute on the price of goods to be settled by contractual payment, or;
- In return for granting a right, e.g. intellectual property

03

Fine or Penalty

Outside VAT Scope: Fine levied for breach of contract terms, performing an unlawful act. Fine / penalty levied by Government authority for unlawful act, e.g. speeding fine or fine for incorrect parking

04

Payment for damaged goods

Outside VAT Scope: Damage or loss of goods belonging to other person (compensation for breaching pre-existing term)

Taxable: Damage or loss of goods where the customer is obliged to take title to it, e.g. customer breaks good and obliged to take title to it.

Our Comments

Ambiguity around issues such as interest / penalty on delayed payment of consideration, foreclosure / early termination charges, damage on property breakage with title transfer etc. comes to rest with this clarification. However, position still remains open on issues such as penalty for property damage without title transfer, non-compete fees, notice pay recovery by the employer etc.



Profit margin scheme – eligible goods (VATP002)

Issue	Whether goods lying in stock as on 31 st December 2017 are eligible for the Profit Margin Scheme which is supplied on or after 1 st January 2018?
FTA Clarification	Only those goods which have previously been subject to VAT before the supply in question may be subject to the Profit Margin Scheme. As a result, stock on hand of used goods which were acquired prior to the effective date of Federal Decree-Law No. (8) on Value Added Tax, or which have not previously been subject to VAT for other reasons, are not eligible to be sold under the Profit Margin Scheme. In such case, VAT is due on the full selling price of such goods.

Our Comments

It would be important for the taxable person opting for Profit Margin Scheme to determine whether the goods are eligible under the scheme and whether they fulfil prescribed conditions including documentary evidence to substantiate that goods have suffered VAT on the earlier supply.



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