

VAT Alert

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VATGAM 1 - VAT Guide on Automotive Sector

Introduction

The FTA has released its first VAT Guide for the automotive sector. In the absence of original equipment manufacturers in the UAE, the supply chain of automobile sector comprises import, sale, and service of automobiles.

With such a supply chain model, a variety of transactions undertaken by Automobile dealers in the UAE have VAT as well as Customs implications. Clarifying taxability on an array of transactions was a challenge faced by the sector.

The FTA in this guide has clarified VAT treatment on various transactions i.e., export and import of cars, supplies under warranty, hire-purchase, leases, promotional schemes, sale of used/ pre-owned cars, etc.

In this alert, we have summarized key points as discussed in the Guide that have an impact on businesses in the automotive sector, along with our analysis.

Key points of the Guide

Sr. No.	Key points	Summary	WTS Dhruva Analysis
1	Sale of cars within the UAE	<p>VAT at 5% is required to be paid as per the date of supply provisions.</p> <ul style="list-style-type: none"> • Outright sales: <ul style="list-style-type: none"> - <u>Date of supply</u> as per Article 25 or Article 26 of the Decree-Law is required to be followed. Furthermore, a tax invoice should be issued and delivered within 14 days of the date of supply. - <u>Disbursement</u> - Any amount charged as disbursement (such as government fee,) shall be, separately and clearly identified on the tax invoice without VAT. 	<ul style="list-style-type: none"> • Timeline to issue tax invoice: Article 67 of the Decree-Law states that the tax invoice should be issued within 14 days of the date of supply, as per Article 25 of the Decree-Law. However, the provision was silent in respect of when to issue a tax invoice in cases where Article 26 was applicable. The Guide provides clarity that the 14-day time limit will apply to Article 26 equally. • Applicability of Article 26 of the Decree-Law on finance companies pertaining to hire purchase arrangements: We understand that many finance companies, on



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		<ul style="list-style-type: none"> Hire-purchase arrangements: There are two separate supplies. First, the supply by motor vehicle trader to the finance company (taxable at 5%) and the second supply by the finance company to the customer. <p>Supply by the finance company includes two components i.e., hire purchase instalments (subject to VAT) and interest, if charged separately (exempt from VAT), otherwise it would be taxable at 5%. Finance companies often issue consecutive/ periodical invoices to which the date of supply as per Article 26 of the Decree-Law is applicable. Thus, there may be a case where the Company has transferred the possession of the car to at the beginning, but it is not liable to pay VAT on the full value upfront (unless the entire amount is received).</p> <p>Repossession of Car - No supply takes place when the finance company repossesses a car. However, when the finance company further supplies the car to another customer, the normal VAT implications arise.</p> <ul style="list-style-type: none"> Trade-ins: Two separate supplies take place: sale of the new car to the customer and sale of the old car by customer to the trader. <p>The trader is not allowed to net off the value of old car against the sales price of new car for the purpose of VAT. This is true even though the value agreed for purchase of old car by the trader is higher than the market value.</p>	<p>a conservative basis, have adopted a position to pay VAT on the full value upfront, irrespective of the applicability of Article 26, as this is treated on a par with permitting the use of car. The Guide reaffirms that VAT needs to be accounted for as and when tax invoices are issued and not on passing the possession of the car (subject to any advance payments).</p> <ul style="list-style-type: none"> Clarity on trade-ins: Many suppliers charged VAT only on the net value of car (sale of new car and purchase of old car), considering it as a single supply. However, in terms of the Guide, the said treatment is incorrect and may have voluntary disclosure ('VD') and penalty implications. <p>Moreover, it is important for the customer to evaluate whether their sale of the old car to the motor vehicle dealer is in the course of his business, whether the VAT registration threshold has been crossed, and whether he/she is liable to charge VAT.</p>



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		<ul style="list-style-type: none"> • Price display: The price displayed by the dealers should be VAT inclusive. However, this is subject to two exceptions i.e., where supply is for export and where the customer is registered. 	
2	Sale of used/ pre-owned cars	<p>Profit margin scheme can be applied on the sale of used cars. The FTA has reiterated the rationale, conditions, and requirements for application of profit margin scheme. It is in line with the Executive Regulations and VAT Public Clarification VATP002 on 'Profit margin scheme – eligible goods' issued by the FTA.</p> <p>Furthermore, the Guide also provides two instances in which some businesses have applied the scheme incorrectly:</p> <ul style="list-style-type: none"> • Applicability of profit margin scheme to cars purchased prior to VAT implementation – The profit margin scheme shall not apply in cases where cars have not been subject to VAT previously. • Cars imported where VAT paid upon import has been recovered – The sale of imported cars in UAE is ineligible for the profit margin scheme, as VAT is generally recovered at the time of import of cars. 	<p>The FTA has highlighted two important non-compliances in the application and use of the profit margin scheme by businesses. To take advantage of the profit margin scheme, businesses should ensure that:</p> <ul style="list-style-type: none"> • VAT was previously charged on the sale value of the car. • The profit margin scheme shall not apply on the import and subsequent sale of cars within the UAE, if input tax was recovered at the time of import. <p>The FTA has further emphasized the importance of adequate documentation to substantiate the claim of sales under the profit margin scheme.</p> <p>Incorrect application of the profit margin scheme would lead to short payment of taxes and entail penalties; therefore, it is imperative that businesses ensure proper understanding and compliance before opting for such a scheme.</p>



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3	Lease of cars	<p>Lease of cars is taxable at 5%. VAT should be charged and paid as per applicable date of supply provisions (Article 25 or Article 26 of Decree-Law).</p> <p>Value of supply in case of lease of cars is the consideration less the tax amount. Certain suppliers have not charged or considered VAT on the entire sum received, treating some of the amounts received (out of the entire sum) as disbursement (i.e., without VAT).</p> <p>Example - a vehicle trader leased a car to a customer. The Salik Account was in the name of the trader. The customer used salik, which was ultimately deducted from the trader's salik account. As part of service and as per the contractual terms, the vehicle trader recharged salik cost to the customer. Such a recharge of cost shall be subject to VAT and would be included in the value of supply.</p>	<p>In terms of the VAT Law and Regulations, disbursement would generally be outside the scope of VAT and reimbursement/ recharges would attract VAT.</p> <p>Several businesses made an error in classifying the transaction either as disbursement or reimbursement. The FTA has provided the following clarity in respect of such an evaluation</p> <ul style="list-style-type: none"> • what are the contractual terms? • who is incurring the cost (salik account is in the name of vehicle trader, as per the illustration provided)? • whether it is a cost incurred for provision of services? • whether it is recharged to the customer? <p>Similar to Salik, there are various additional charges recovered by car rental companies, such as refundable deposits, service charges, additional insurance, penalties etc. Such charges may or may not be subject to VAT. Hence, businesses should take an informed view on the applicability of VAT on such charges.</p>
4	Export of cars	<p>The FTA provided the conditions for direct and indirect export of cars, and also highlighted the importance of export documentation (official and commercial evidence) to justify any export of goods. The vehicle trader may seek an exception in cases where any of the evidence is missing.</p> <p>FTA has re-emphasized the option of obtaining an exception for non-fulfilment of stipulated conditions.</p> <p>Multiple sale of cars resulting in single export: Where a single export is backed by</p>	<p>Clarity on indirect export:</p> <ul style="list-style-type: none"> • It is relevant to note that for a transaction to be considered as an indirect export, the customer should be an overseas customer. • Many businesses have erred in interpreting the indirect export provisions. • It is important to analyze the transactions where the customer is in the UAE and automobiles are eventually exported outside the UAE. In such a case, the transaction between the automobile dealer and the customer in the UAE may be subject to VAT at 5%, since the customer is based in UAE and not overseas.



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		two or more underlying supplies, only the final supply is treated as zero-rated.	<ul style="list-style-type: none"> Businesses should note that if the relevant export documents to justify export is missing, then the transaction shall be subject to VAT at 5%.
5	Import of cars	<p>The FTA has provided the conditions for import and its accounting, deferred payment, import using clearing agent and import VAT suspension and exemption. The same is in line with Decree-Law and previous Guides issued by the FTA.</p> <p>In addition to the above, the FTA has clarified the disclosure requirement under the VAT return in the case of Purchase returns after import, as follows:</p> <ul style="list-style-type: none"> At the time of import – <ul style="list-style-type: none"> Accounting import VAT under Box 6 of the VAT return. Recovering VAT under Box 10 of the VAT return. At the time of purchase return – <ul style="list-style-type: none"> A negative adjustment should be made under Box 7 and Box 10 of the VAT return. 	<p>We would like to refer to VAT Returns User Guide issued by the FTA in May 2018, which states regarding Box 7 that:</p> <p><i>“You should use this box only if the information that is prepopulated in Box 6 regarding goods imported into the UAE is incomplete or incorrect.”</i></p> <p>Based on the above, there was a common notion within the industry that Box 7 on “Adjustments” can only be used in cases where any adjustment is in relation to Box 6 of the same tax period. Accordingly, businesses took the position that any purchase return shall be treated as export of goods outside the UAE, and accordingly it should be disclosed under Box 4: Zero-rated supplies (subject to the availability of appropriate official and commercial evidence).</p> <p>However, the FTA in the guide has clarified that Box 7 can be used in respect of other tax periods as well, for purchase return-related transactions. Hence, businesses are required to perform a negative adjustment under Box 7 and Box 10, instead of disclosing the transaction as zero-rated supplies under Box 4 of the VAT return.</p> <p>Additionally, an important point pertaining to an exception from import VAT has been provided, i.e., if any conditions for VAT suspension are subsequently violated, goods can be treated as being imported into the UAE and VAT shall become due on the import from the date the goods were originally imported.</p>
6	Warranty Services	Warranty is provided to the customer at the time of sale of the car. The price of the manufacturer’s warranty is included in the price	VAT treatment for warranty services should be determined on the basis of whether the cost of warranty is included in the price of the car, or



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		<p>of the car, and any extended warranty may be sold separately.</p> <p>The VAT treatment under both cases shall be as follows:</p> <ul style="list-style-type: none"> • The warranty is included in the price of the car at the time of the sale: <ul style="list-style-type: none"> - No VAT implication would arise for the actual repair services, as VAT has already been accounted for in the original value of the car (which includes the cost of the warranty) - Input tax incurred on carrying out warranty repair services will be recovered • Extended warranty for a consideration: <ul style="list-style-type: none"> - An extended warranty should be subject to VAT at 5%. - No VAT Implication on the actual repair services. <p>Reimbursement of repair costs by distributors from manufacturers</p> <p>There are two separate supplies in this arrangement, from a VAT perspective:</p> <ul style="list-style-type: none"> • Warranty services provided by the distributor to the customer - No VAT implication would arise for the warranty services as the cost of warranty service is factored into the price of the car. • Supply made under a warranty arrangement on behalf of the manufacturer - Any recovery shall be subject to VAT at a standard rate of 5%, 	<p>any additional amount is recovered from the customer.</p> <p>Actual repairs services provided during the warranty period shall have no VAT implication in both the cases.</p> <p>Reimbursement of expenses from the overseas manufacturer during the warranty period shall be considered a separate supply and subject to VAT at 5% as the condition prescribed for exports of services are not met (services are provided in connection with goods in the UAE).</p>



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		<p>being services in connection with goods physically located in the UAE.</p>	
7	Auctions	<p>The Auctioneer may either act as owner/ principal seller of the car or may act as an agent on behalf of another person selling the car.</p> <p>The VAT treatment under each case shall be as follows:</p> <ul style="list-style-type: none"> • Auctioneer acting as the principal supplier (as Undisclosed Agent): In such cases, there would be two supplies from a VAT perspective: <ul style="list-style-type: none"> - Between the seller and the auctioneer – Subject to VAT at 5% - Between the auctioneer and the end customer – Subject to VAT at 5% or 0% (if car is exported outside UAE and subject to meeting the export condition) • Auctioneer acting as an agent on behalf of the supplier (as Disclosed Agent): The supply would take place directly between the owner and customer subject to VAT at standard rate of 5 % or 0% (subject to meeting export condition) • Commission/ Premium charged by the Auctioneer – would be subject to VAT at 5%. 	<p>The explanation of the VAT treatment on this transaction is as per Article 9 of the VAT Law. Additionally, the FTA has also elaborated on the VAT implications on principal – agent model in the E-commerce Guide issued by the FTA in August 2020.</p> <p>It is important that such arrangements are clearly documented in the agreement between the principal and the auctioneer (agent) clearly providing the responsibilities of each party.</p>
8	Promotions and Discounts	<ul style="list-style-type: none"> • Free promotional gifts - Free promotional gifts given as a part of promotional offers may be classified as deemed supply provided input VAT has been recovered on the purchase of such gifts. • Discounts - Discounts given by traders to the Customer: VAT would apply on the discounted price. The discount offered should be clearly stated on the tax invoice. 	<p>There are various arrangements entered between the original manufacturer, dealers and customers depending on the type of automobile, nature of promotions, market requirements etc.</p> <p>Not all such arrangements should be subject to VAT. For e.g., one can contest that any free supplies that are given along with principal supplies may not be considered as deemed supplies.</p>



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		<ul style="list-style-type: none"> • Various discounts received by dealers from the manufacturer: <ul style="list-style-type: none"> – Bulk discount/ volume discount – Discount given on the purchase of specified number of units. Such a discount should be clearly reflected in the invoice. – Contingent discount or payment i.e., discount or payment received by the dealer on achieving a sales target – the VAT implication should be determined considering that either the stated discount leads to a reduction in the price of cars or is given on performance of a specific activity. <p>Where the discounts lead to a reduction in the price of cars, a credit note should be issued to reduce the value. If the payment/ discount is given to perform a specific activity, it should be a consideration for separate supply. The dealer would be required to issue a tax invoice and charge VAT at the applicable rate.</p>	<p>Therefore, such arrangements warrant special attention, as they result in either a consideration being paid by manufacturer to dealers, or a reduction in the cost of products purchased by the dealer.</p> <p>In our experience, one must investigate the contract and the main intention of such arrangements to bifurcate between cost reduction vis-a-vis the payment of a consideration to identify the correct VAT treatment.</p> <p>Additionally, such arrangements may have an impact on Customs Duty paid at the time of import of such products, which would need to be analyzed separately. To elaborate on the reduction of import price, should the customs duty paid while importing such goods be reduced or not</p>
9	Company cars	<p>Input VAT should not be recovered on expenses, such as maintenance, insurance, servicing etc. on the purchase, rent or lease of a company car available for personal use.</p> <p>Input tax can be recovered in the event that a car is taken home by an employee, provided the vehicle is only available for emergency purposes or the nature of the job and use of the vehicle is such that it requires the employee to keep the vehicle.</p>	<p>The FTA has given an important clarification that an employee merely taking a car to their home shall not be construed as the car being made available or put to personal use. It may be dependent on the nature of the job (e.g., area sales manager), which may require the employee to keep the vehicle with the employee.</p> <p>This is a good window of opportunity for logistics and e-commerce companies to explore discussions with the FTA and reclaim VAT on</p>



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			<p>their delivery vans, which until now they have not recovered.</p> <p>It is important to consider how to convince the FTA in cases where employees take cars to their homes.</p>
10	Demo Cars	<p>Demo cars are available in showrooms for demonstration/ test drive purposes. Manufacturers provide discount/ payment in respect of demo cars to compensate the trader for the lower retail value. The following two arrangements have been provided:</p> <ul style="list-style-type: none"> • Payment made by the manufacturer is a genuine reduction of the original sales price - Such a payment will be considered as a retrospective discount. The original manufacturer should issue a credit note to reduce the original sales price. • Payment pertains to considerations to perform a specific activity (such as marketing services) - The payment will be treated as a consideration for a taxable supply. A tax invoice should be issued with an applicable rate of VAT. 	<p>Any one-off payment given by the manufacturer to the dealer to compensate for loss in relation to demo cars should be identified, whether the payment is in relation to a reduction in the price of a car or relation to any specific activity, such as marketing services. VAT treatment in such cases should be determined accordingly.</p>

Key Takeaway for Businesses:

In light of the clarification above, businesses should critically evaluate the following:

- ✓ Erstwhile tax positions.
- ✓ The supporting documents/ information (contracts, invoices etc.), based on which such tax positions have been adopted.
- ✓ The manner in which the transactions/arrangements have been documented/described in the agreements
- ✓ Internal checklist/ tax policy framework for such transactions
- ✓ Potential tax exposure and the way forward in terms of filing VDs, approaching FTA for further clarifications, etc.



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