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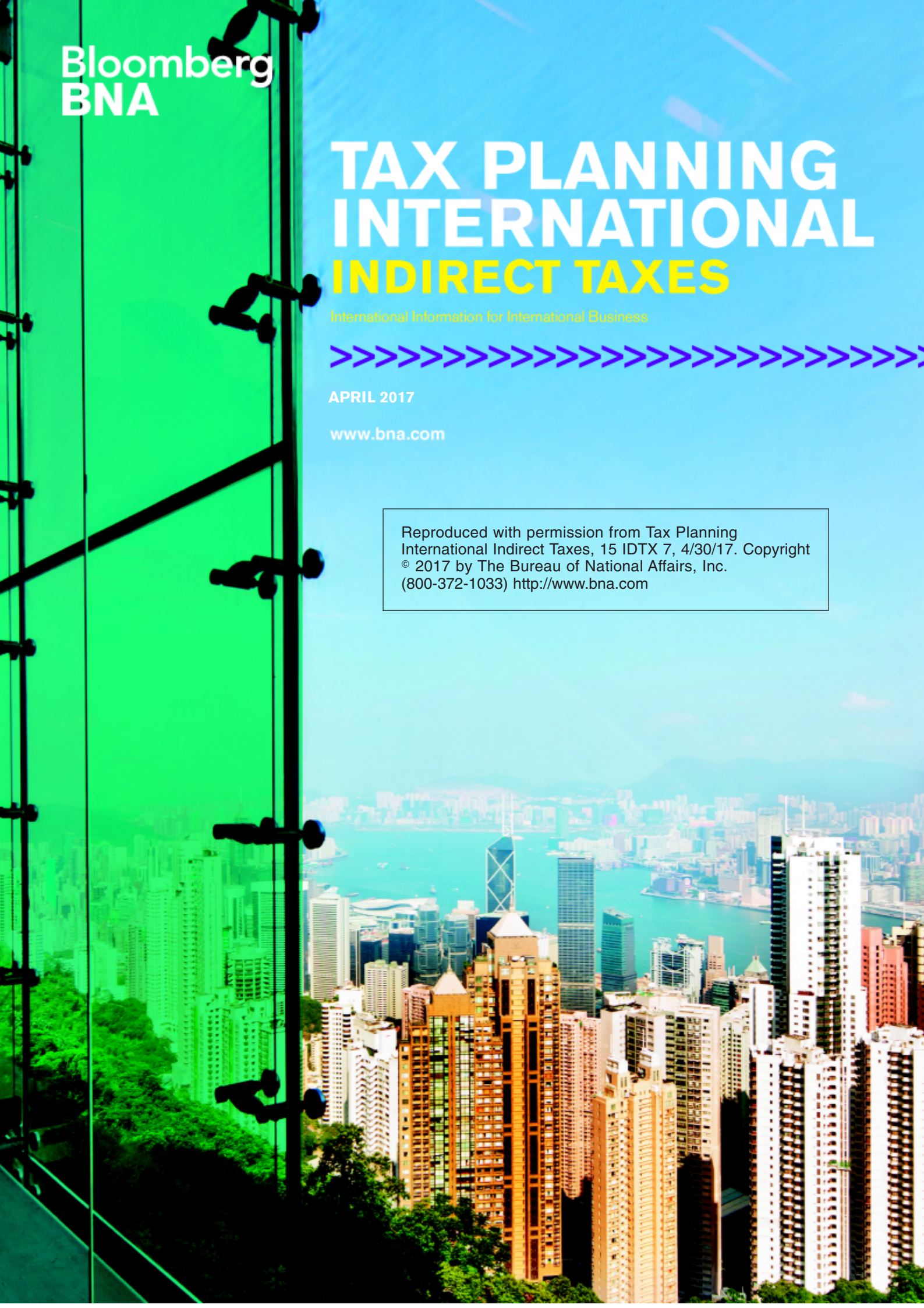
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# VAT in the Gulf: the Real Estate we're in



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As the six countries of the Gulf Cooperation Council continue to prepare for the introduction of VAT on January 1, 2018, this article looks at the potential impact on land transactions.

**T**he six countries of the Gulf Cooperation Council (“GCC”) are continuing to prepare for the introduction of VAT on January 1, 2018, and are announcing more details, although there remains no published legislation.

As the construction sector in the GCC continues to boom, we focus in this article on the impact of VAT on transactions in land. The experience of VAT in the U.K., European Union and other parts of the world is that this can be a complex area where careful attention needs to be paid, particularly in a region that does not have a sophisticated tax regime.

## Goods or Services?

VAT is fundamentally a tax on goods and services. Land does not always sit comfortably within this framework—conceptually, it is neither “goods” nor “services” as those terms are commonly understood. For the purposes of VAT, supplies in respect of land are therefore deemed to be one or the other.

According to economic theory, VAT should be introduced as a universal tax on economic activity. For political purposes, including the regressive nature of VAT, exceptions are often made for supplies that are regarded as being for the public good, such as health-care and education.

Governments typically take a similar approach to certain land transactions, for example residential transactions where most buyers will not be VAT-registered businesses. Whilst done for understandable reasons, such exceptionalism often results in additional complexity, partly because boundaries have to be set, sometimes arbitrarily, between the different categories of transaction.

## UAE Proposals

Against this background, how do the current GCC proposals measure up? Focusing on the United Arab Emirates (“UAE”), in March the UAE Ministry of Finance (“MoF”) confirmed a three-way approach to land:

- sales of bare land will be exempt from VAT;
- transactions in commercial land will be subject to VAT;
- transactions in residential land will be exempt from VAT, except for the first supply of new residential property which will be subject to VAT at the zero rate.

In addition, the MoF confirmed that there will be special rules for transfers of going concerns. These

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may also be relevant to land transactions. We would expect the legislation to provide additional detail and complexity.

### Market impact

Looking first at transactions in bare land, the exemption means that no VAT will be chargeable on sales but sellers will not be able to recover input VAT in respect of such supplies, e.g. legal costs. This could be costly where a seller has carried out preparatory works on the land to allow a development to take place. The seller may wish to increase the sale price to compensate for the irrecoverable input VAT, or may need to absorb it. Either way it becomes a permanent cost of the project. In some VAT systems, sellers are given an option to charge VAT on a sale in this situation. This allows the seller to reclaim input tax and, so long as the buyer can reclaim VAT paid on the purchase price, there is no permanent additional cost. For reasons perhaps of simplicity, the MoF does not at this stage seem to be planning for an “option to tax”.

In contrast, if the sale falls within the definition of commercial land, it appears that VAT will always be chargeable, unless, perhaps, it qualifies as a transfer of a going concern—another layer of complexity which can mean that a transaction that would otherwise be a supply is treated as not being so, which may have a number of consequences.

Where the buyer is going to use the property for the purposes of a VATable business (including commercial letting), then the VAT paid on the purchase price should be recoverable as input VAT—but will still have to be funded by the buyer until the input VAT credit or refund is received.

“Having different VAT treatments for different land transactions makes VAT more complex”

In the case of a development site where the owner has already incurred some VAT, it may be better for the owner to do further works so that the land

qualifies as commercial rather than bare land. The works would be funded by the buyer through the price paid for the land. The amount of work needed will, of course, depend on how “commercial land” is defined, and we would expect there to be litigation on this point in the future.

Residential property gives rise to additional issues. Zero rating of new residential property means that the buyer or tenant of a new home will not pay VAT but the seller will be entitled to reclaim VAT paid on construction costs. From a policy perspective, this ensures that VAT does not inflate costs and, therefore, sale prices.

All other transactions in residential land will then be exempt from VAT. For landlords this means that their costs will be increased by the VAT they have to pay on things like maintenance and repairs. Lease terms will need to be checked to see if this additional cost can be passed on to tenants in the form of higher service charge or rent.

### Conclusion

Having different VAT treatments for different land transactions makes VAT more complex. Transactions may need to be restructured to secure the most favorable VAT treatment. Over time, this can introduce distortions into the market, particularly if (as we expect) the VAT rate increases in the future. It may also result in further complexity as changes in law are made to shift the boundaries to favor particular situations or block attempts by taxpayers to take advantage of the system.

Many land transactions take place over long timescales, particularly where land is being acquired for development. Planning ahead is key but this is difficult without seeing the detailed wording of the relevant VAT law. Stakeholders in the GCC real estate sector will need to keep a close eye on how the VAT rules develop in the coming months, and review contracts now, to ensure that they are not caught out next January.

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