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DAWN OF A NEW TAX ERA – CORPORATE PERSPECTIVES

Following the implementation of VAT in the UAE from 1 January this year, this briefing outlines the impact of the new regime in respect of M&A transactions and directors' duties. This briefing also highlights the potential impact of the UK's recently implemented corporate criminal offence of tax evasion.

BACKGROUND

In a move to diversify state revenues away from hydrocarbons, the GCC member states have turned their attention to introducing VAT (and excise tax) as an effective method of raising alternative state revenues.

Accordingly, on 27 November 2016, all Member States of the GCC agreed to sign the GCC VAT Framework Agreement (Common VAT Agreement), a multilateral treaty which introduced a legislative framework for the implementation of VAT in the GCC region. The GCC VAT system is a traditional VAT system, which draws inspiration from the European VAT directive. According to the treaty, all GCC countries are expected to implement VAT in their domestic legislation by 1 January 2019.

The UAE and the Kingdom of Saudi Arabia emerged as frontrunners by opting to introduce VAT as early as 1 January 2018. Since last April we have seen a host of UAE legislation issued to ensure implementation of the UAE's VAT regime at the start of this year. More recently Cabinet Decisions have been issued confirming, amongst other matters, the status of the UAE Designated Zones, which receive different VAT treatment under the regime.

VAT OBLIGATIONS OF REGISTERED BUSINESSES

It goes without saying that the introduction of VAT will have a significant impact on businesses in the UAE, and Saudi Arabia. Businesses which were previously operating in a virtually non-tax environment will now have to comply with various obligations imposed by the VAT legislation. Not only will businesses have to register and charge VAT to their customers, they will also have to prepare and submit periodic VAT returns and pay VAT to the competent tax authorities. Furthermore, businesses will have to issue compliant invoices and comply with extensive accounting obligations.

UAE VAT legislative framework:

- Ratification of GCC Common VAT Agreement
- Establishment of UAE Federal Tax Authority (FTA)
- Implementation of UAE Tax Procedures Law
- Issue of UAE VAT Law
- Issue of UAE VAT Executive Regulations
- Issue of Cabinet Decision confirming status of Designated Zones
- Issue of Cabinet Resolution confirming definitions of Medications and Medical Equipment for the purpose of zero rating.

VAT'S IMPACT ON M&A TRANSACTIONS

Asset sales

The transfer of a business as a going concern (TOGC) may include the sale of assets that could otherwise be treated as taxable supplies and therefore give rise to a VAT liability. However, under the UAE VAT legislation, a TOGC is not regarded as being a supply of goods or services for the purposes of VAT where the whole or an independent part of a business is sold to a Taxable Person for the purpose of continuing that business.

In determining whether a proposed asset sale will fall within the TOGC exemption, there will be a number of factors to consider. In lieu of established practice at this stage, it may be helpful to draw comparisons from other regimes such as the UK. For instance, positive factors suggesting TOGC treatment on a transfer assets would include:

- The assets (along with accompanying liabilities) comprise clear independent operations from other parts of the business (shared services are unlikely to be a fatal factor in themselves)
- The assets represent a going concern presently and are capable of being operated separately (this would not require the business to be profitable)
- The assets have been used to make supplies, not merely used for the overheads of the business
- The purchaser will use the assets to run the same type of business without a significant break in trading (although changes to the operation of business, types of products sold etc are typically acceptable in jurisdictions such as the UK).

In addition, for TOGC treatment, the seller should be a Taxable Person (ie have a VAT registration number) and the purchaser must be a Taxable Person already or become one as the result of the transfer. Transfers within a VAT group are also likely to be outside of the scope without the need to consider TOGC treatment. Cross border transfers will need to be carefully considered – the export rules may apply rather than TOGC and intra-GCC (other than KSA) may remain relatively complicated during the period before full implementation across the region.

Where there is uncertainty, a referral to the FTA may be considered, although there is no requirement to do so. In the early years of implementation, until a body of practice has developed, parties may wish to adopt a cautious approach in making such referrals. We understand that the FTA will be developing a ruling practice which can be used to that effect.

Share sales

Similarly, the sale of shares would fall outside of the VAT rules since such transactions would not be an example of a taxable good or service for business/consumption purposes. Entities that buy and sell securities by way of business should benefit from the financial services exemption relating to the issue, allotment and transfer of equity and debt securities detailed in the VAT Executive Regulations. We are not aware of any present intention to introduce a stamp duty on share transfers.

SPA considerations

VAT covenants and warranties will likely now be expected by purchasers of businesses in the GCC. This will mean, unlike sale processes prior to VAT implementation, a review of tax compliance and future liabilities will now typically be included as part of the diligence phase. A typical tax indemnity on a share transaction seeks to allocate liability for historical tax compliance and warranties would also be sought dealing with issues such as due registration with a tax authority and that no investigations/judgments are pending. Additional provisions may be required if the target is in the seller's VAT group. Such contractual protections would be different on an acquisition of assets where the seller would generally retain such risk. Nevertheless, the VAT impact on business revenues will remain a key area of focus which sellers may be expected to provide warranties against.

From a financial side, transactional analysis would also need to include consideration of VAT assets and liabilities on the balance sheet, the accounting provisions regarding receivables and any outstanding claims or amounts due from the tax authority.

HARSH PENALTIES IN CASE OF INFRINGEMENTS OF THE VAT LAW

To ensure that all taxpayers comply with these extensive obligations, the competent tax authorities in each Member State have been granted the power to impose substantial administrative fines. In addition to these administrative fines, the tax authorities may impose more severe penalties (eg prison sentences) in case of infringements that are considered tax evasion. Moreover, the tax authorities may claim any VAT which is due as a result of incorrect reporting or wrongly deducting input VAT.

Violation	Penalty – UAE AED
Failure of the registrant to submit the tax return within the specified timeframe	• 1,000 (first violation) • 2,000 (repeated violation within 24 months)
Failure of the taxable person to settle the payable tax stated in the submitted tax return or tax assessment as notified, within the specified timeframe	Late payment penalty of: • 2% of the unpaid tax is due immediately once the payment of payable tax is late • 4% is due on the seventh day following the deadline for payment, on the amount of tax which is still unpaid • 1% daily penalty charged on any amount that is still unpaid one calendar month following the deadline for payment with an upper ceiling of 300%.

WHO IS LIABLE FOR PENALTIES?

Businesses will face a high risk of financial exposure in case of non-compliance with their VAT obligations since they will be liable for any VAT debts or penalties vis-à-vis the tax authorities.

Unlike in other jurisdictions, tax procedure laws in the GCC do not provide for a joint personal liability in respect of company directors, executives, managers or any other officers who are responsible for the day-to-day management of the company (Company Executives).

In Europe on the other hand, Company Executives can be held liable by the tax authorities in case the company does not comply with its VAT obligations (eg non-payment of VAT or penalties by the company) or in situations where the company has incurred a VAT liability or penalties as a result of the shortcomings of a Company Executive. The ability for tax authorities to pursue Company Executives provides them with an additional opportunity to collect VAT in case of company insolvency and puts additional direct pressure on company directors.

By way of illustration, we have included an overview of the applicable liability regimes for a selection of European Member States:

- In the UK, HM Revenue & Customs (HMRC) has the ability to pursue a Company Executive personally for any penalties that it has been unable to collect from the business, provided that it can prove that the error was a deliberate and dishonest attempt by a Company Executive to evade VAT
- In Belgium, Company Executives can be held jointly liable in case of a civil error which gave rise to the non-payment of VAT
- Luxembourg only recently introduced a personal liability for Company Executives (as from 1 January 2017). Company Executives can now be held personally and severally liable in the event of a breach of VAT compliance obligations and/or non-payment of the VAT which is payable by the company which they manage.

However, given the breadth of directors' duties under the UAE's Commercial Companies Law, which are owed to the company, shareholders and third parties, including in relation to errors in management, it is possible that the FTA could seek to impose penalties against directors, particularly where such penalties relate to tax evasion.

NEW EXTRA-TERRITORIAL UK CRIMINAL OFFENCE OF FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

In the context of the UAE's new tax regime, it is noteworthy that the UK has enacted a new corporate criminal offence of failing to prevent the facilitation of tax evasion by employees and other associated persons. Reflecting a trend to extra-territoriality in UK legislation in recent years, the offence is highly extra-territorial, applies to businesses worldwide, and can apply to the evasion of non-UK taxes as well as UK taxes. The only defence available is for businesses to show that reasonable procedures are in place to prevent facilitation of tax evasion. The offence came into effect from 20 September 2017.

With the advent of the UAE's tax laws, the extra-territorial scope of this UK criminal offence creates new risks for UAE businesses and UK group companies with UAE holdings. For instance, an offence would be committed if an employee of a UK company deliberately facilitated tax evasion in the UAE. An offence would also be committed if an employee of a UAE (or any other internationally incorporated entity) facilitated tax evasion in the UK.

The penalty for being successfully prosecuted under one of these offences is an unlimited fine. However, there is also the risk of considerable reputational damage and there could be potential regulatory consequences for regulated businesses (eg loss of a regulatory authorisation as no longer deemed to be a fit and proper person).

CONCLUSION

Following the introduction of VAT, businesses will be forced to comply with a large number of obligations imposed by VAT and tax procedure laws. The tax authorities have been granted the power to impose administrative fines and other penalties to ensure compliance with these extensive obligations. VAT and VAT liability should therefore be factored in as part of any share or asset purchase diligence processes and documentation.

The VAT regime should also be considered in the day-to-day context of a business' overall liability and the scope of the penalties serve to underline the importance of being fully compliant with VAT legislation in order to avoid the risks of sanctions and/or additional VAT assessments. Taxpayers should carefully consider their VAT position, review their contracts to ensure VAT risk is allocated appropriately, implement efficient processes, and properly monitor their VAT obligations to ensure compliance with the VAT law. Further, given the potential scope of director liability, businesses may want to plan ahead and verify agreements with directors and their liability insurers.

In respect of UK tax evasion, businesses may also wish to consider conducting risk assessments in respect of their controls, policies, procedures and provide training to prevent falling foul of the new extra-territorial offence.

CONTACTS

James McCarthy
Partner

T +971 4 503 2628
E james.mccarthy@cliffordchance.com

Jack Hardman, CFA
Senior Associate

T +971 4 503 2712
E jack.hardman@cliffordchance.com

Katherine Nixon
Senior Associate PSL

T +971 4 503 2730
E katherine.nixon@cliffordchance.com

Thomas Vanhee
Aurifer - Partner

T +971 4 383 5361
E thomas@aurifer.tax

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Clifford Chance, Level 15, Burj Daman, Dubai International Financial Centre, P.O. Box 9380, Dubai, United Arab Emirates

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