

Annual Input tax apportionment – Are businesses following the correct approach?

Annual input tax apportionment is a yearly activity which businesses engaged in provision of taxable and exempt / non-business supplies should undertake post completion of a tax year. Annual input tax apportionment involves the following activities:

- Wash-up adjustment – it involves computing input tax for the entire tax year as per standard method and comparing with the input tax recovered in respective tax periods. The difference is to be adjusted by the businesses
- Use-based adjustment – it involves applying applicable special input tax method for the entire year and comparing with the input tax recoverable as per above-mentioned wash-up. If the difference is more than AED 250,000 then the same is to be adjusted by the businesses

The adjustments arising out of the annual apportionment (i.e. wash-up and use-based adjustment) needs to be given in the first tax period of subsequent tax year. In other words, the adjustment (i.e. true-up) for annual adjustment for the tax year 2019 (which may end on December 2019 for certain taxpayers) needs to be considered in the first tax period of the year 2020, i.e. tax period January 2020 in case of monthly tax filing or tax period January to March 2020 in case of quarterly filing.

Before undertaking the annual adjustments, it is imperative for the businesses to evaluate whether the appropriate process of claiming input tax is being followed in respective tax periods. As per the VAT regulations, businesses should classify the input tax as below:

- Expenses fully attributable to taxable supplies
- Expenses fully attributable to exempt / non-business supplies
- Residual input tax
- Blocked input tax

It is advisable to use different tax codes in the accounting system basis the above classification. Residual input tax is to be claimed basis the ratio of taxable supplies and exempt / non-business supplies.

Here, it is possible that the businesses may inadvertently classify input tax under the aforesaid categories, and this may impact the input tax recovery ratio leading to incorrect VAT payments. Also, it is observed that certain exempt supplies are missed to be considered by the businesses such as interest earned on inter-company loans, provision of residential accommodation to employees, margin earned on currency remittance / exchange transactions, etc.

To avoid errors, certain key processes which businesses should consider are as below:

- Regular evaluation to ascertain if the business provides any exempt / non-business supplies
- Appropriate classification and regular review of expenses into above-mentioned categories
- Avoid back-dated expense entries as it may impact the input tax recovery ratio
- Ascertain the tax treatment of one-off transactions as it likely to be missed out by the businesses
- Input tax claimed under reverse charge is also to be categorised under above-mentioned categories
- Exempt supplies provided to entities outside UAE should be regarded as zero-rated

Post completion of the tax year, businesses should undertake wash-up adjustment, i.e. computing input tax for the entire year and making adjustments on comparison with input tax claimed in respective tax periods.

With regard to use-based adjustment, it is advisable for the businesses to undertake following key steps:

- Evaluate the applicable special input tax method considering the nature of business / sector in which business operates
- Post identification of the method, ascertain input tax claimable as per the special method
- If the difference in input tax as per standard method and special method is likely to be more than AED 250,000 then appropriate adjustment needs to be undertaken in the first tax period of subsequent year
- It is advisable for the businesses to make an application to the Authority for approval of special method along with supporting documents (if the input tax difference is more than AED 250,000) as the said method should be used in subsequent year to reflect that input tax is claimed basis the 'use' towards taxable supplies. While a view could be taken to follow standard method in subsequent year and apply special method for undertaking use-based adjustment; same appears aggressive and is untested yet
- Updated Input tax Apportionment guide issued by the Authority should be considered to ensure that there are no errors in the application for special method

Often it is observed that large groups in UAE may regularly provide loans to other group entities and earn interest on such transactions (regarded as exempt supply). While such transactions do not have any direct expenses and basis this as per the standard method entire input tax may be claimable. However, on application of special method, i.e. output based method (post completion of tax year) there is a possibility that input tax may reduce substantially considering the value of interest and value of taxable transactions. Here, a contention could be that special method should not apply as all the expenses are actually used towards taxable supplies and none of the expenses (partially or fully) can be allocated towards earning interest. Basis this, businesses may consider adopting standard method. An alternate thought could be that certain expenses relate to entire business for example – rent, professional fees, audit fees, telephone expenses, etc and it may not be true to allocate wholly towards taxable supplies. With this perspective, there is a possibility of application of special method, however same may lead of input tax cost. It is advisable to seek Clarification from the Authority on this aspect.

It is possible that few businesses may have an entire division for managing funds / investments, etc. In such cases, businesses should consider evaluating application of special method and may undertake steps as specified above.

To summarize, businesses should prudently evaluate the input tax classification and the nature of supplies (i.e. taxable, exempt, non-business, etc) including computing claimable input tax and undertaking annual adjustments. Also, it is critical to ascertain whether special method is to be applied, and same can be used post approval from the Authority.