

Federal Supreme Court restricts tax clarification disputes

May 14, 2021

In late April 2021, the UAE Federal Supreme Court issued the first judgments on disputes arising out of tax private clarifications.

The disputes had previously been adjudicated on by the Dubai tax dispute resolution committee, and by the Federal Primary Court and the Federal Appeals Court.

The Federal Supreme Court rejected the previous judgments and ordered that private clarifications issued by the Federal Tax Authority do not fulfil the requirements to be disputed.

Private clarification disputes

Previously, there was a level of procedural ambiguity with respect to disputes over private or public clarifications issued by the Federal Tax Authority.

These are disputes over decisions by the Federal Tax Authority that do not have an immediate monetary value; in comparison with a dispute over a tax assessment or voluntary disclosure, and the penalties arising thereof.

There have been different judicial interpretations on this particular issue as to whether a dispute that has no immediate monetary value (such as a private or public clarification dispute) can be accepted by the tax dispute resolution committees and Federal courts.

As a general matter, the Tax Procedures Law and the Cabinet Decision forming the tax dispute resolution committees require that a tax dispute litigant settle any taxes and/or penalties in dispute prior to objecting before the competent TDRC, which implies that tax disputes require a monetary value to be attached to the dispute.

However, general administrative law grants any person the right to dispute an administrative decision if that decision alters the legal position of the person subject of that decision, or if that decision affects (or potentially affects) the interest of the disputing person.

In some instances, the tax dispute resolution committees had accepted disputes over private clarifications. In other instances, the committees had rejected such disputes.

The Federal Primary Court and the Federal Appeals Court had also accepted disputes over private clarifications and ruled on their subject matter.

In April 2021, the Federal Supreme Court addressed this issue for the first time.

Federal Supreme Court decision

In its interpretation, the Federal Supreme Court reasoned that private clarifications are not administrative decisions – i.e., are not disputable decisions – because they do not alter nor cancel the legal position of the person to whom the decision is addressed.

To provide a comparable illustration of the nature of private clarifications issued by the Federal Tax Authority, the Court compared private clarifications to internal guidelines, and legal reports and commentary.

Finally, the Court established a private clarification cannot be disputed until such clarification results in tax or

penalties being applied to the disputing person.

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Breaking News: UAE tax penalties reduced and discounts granted

May 14, 2021

On 28 April 2021, the UAE Cabinet of Ministers issued Decision No. 49/2021 amending provisions of Cabinet Decision No. 40/2017 regulating tax penalties (the “new Decision”).

Important highlights:

- Late payment penalties reduced from 1% per day to 4% per month.
- 300% cap still applies.
- New starting date for calculating late payment penalties.
- Reductions for prior penalties to be made.
- Effective sixty days as of 28 April 2021.

Detailed updates below:

Penalty calculation:

Most notable of the new amendments is that the late payment penalties have been reduced from 1% per day to 4% per month.

The 300% cap on the late payment penalties still applies.

The new calculation of late payment penalties will be as follows:

- 2% of the unpaid tax immediately past the due date.
- 4% per month thereafter commencing a month after the due date.

Due date / start of penalties:

In October 2020, the UAE Federal Supreme Court ordered that late payment penalties should apply retrospective to the voluntary disclosure, calculated as of the date of the original tax return.

However, the new Decision states that the due date for the purposes of calculating late payment penalties shall be:

- 20 weekdays as of the date of submission of a voluntary disclosure.
- 20 weekdays as of the date of receipt of a tax assessment.

The text of the new Decision is explicit and reads to apply the late payment penalties 20 weekdays from the date of submission of a voluntary disclosure or receipt of a tax assessment, as opposed to retrospectively from the date of the original tax return.

(This should be read in caveat with the Supreme Court judgment of October 2020.)

Discounts for previous penalties:

The new Decision grants the Federal Tax Authority the right to reduce previously unpaid penalties to 30% of the total of

such penalties where the following conditions are met:

- The penalties were applied under the previous Cabinet Decision No. 40/2017 regulating tax penalties.
- The registrant has paid all taxes due by 31 December 2021 at most.
- By 31 December 2021, at most, the registrant must have paid 30% of the total tax penalties owed until the coming into effect of the new Decision (i.e., sixty days as of 28 April).

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Federal Court finally defines and provides a test for the Tax Benefit Penalty

May 14, 2021

Recently, in a dispute that Wasel & Wasel was counsel on, the Federal Primary Court ruled providing a definition and test for the 'tax benefit' penalty for the first time.

What is the 'tax benefit' penalty?

Of the various tax penalties that are applied by the Federal

Tax Authority in the United Arab Emirates is the 'tax benefit penalty' which ranges between 5% to 50% of the tax liability.

The legislator included two tests under the application of the penalties under § 10(2) of table 1 of Cabinet Resolution 40/2017:

- An error had occurred; and
- A tax benefit had been obtained.

The tax legislation, and general laws of the UAE, do not define 'tax benefit', hence whether a party has or has not obtained a tax benefit that should result in the penalties has been a matter of debate.

A 'tax benefit' is described by the UNCTAD (United Nations Conference on Trade and Development) as the financial, measurable value that distinguishes the source of funding from other sources, which results in incentive tax effects that reduce the tax burden and raise the company's return.

Issue

If a tax benefit is deemed to be an increase in revenue against a reduction in a tax burden, then the question becomes should the tax benefit penalty apply if a person who submits a voluntary disclosure, or is subject of an audit, pays the value added or excise tax without having originally collected it from the end customer.

Often, tax registrants are unaware that tax needs to be applied to a particular transaction.

The awareness comes at a point of a public or private clarification, or as a result of an audit where the audit assessment informs the registrant that certain transactions should have taxable.

At times, the registrant would not have collected the tax from the customers but nonetheless pays the tax to the Federal Tax

Authority as a result of voluntary disclosure or audit assessment.

In these cases, the registrant suffers a tax detriment as they would have paid the taxes without having collected said taxes from their consumers, leaving the registrant in a negative financial position with respect to their tax position.

Judgment

Recently, in deciding on whether the tax benefit applies to a registrant company, the Federal Primary Court ruled providing a definition for the first time.

There is no explicit unified definition of 'tax benefit' in UAE legislation so the Defendant argued that a 'tax benefit' is a preferential position over other taxpayers which could arise for the purposes of § 10(2).

The Federal Primary Court concurred with the argument and ruled that the tax benefit penalty should apply:

"In order not to reap the fruit that the taxpayer does not deserve by his negligence, represented in the taxpayer obtaining a tax benefit that has not been decided for others, represented in the exploitation of the tax resources in his possession until the date of the declaration."

The ruling provides a significant development in understanding the point at which a tax benefit is arguably triggered or not, and when the 5%, 30%, or 50% penalty should apply.

The definition provided by the Federal Primary Court also creates a test for taxpayers to consider when assessing whether the tax benefit penalty should be applied, and the threshold to which they need to substantiate to argue that no tax benefit had been obtained.

In the legislation

The tax benefit penalty applies where an error ends up *“resulting in a tax benefit”*.

The legislator included two tests under the application of the penalties under § 10(2) of table 1 of Cabinet Resolution 40/2017:

1. An error had occurred; and
2. A tax benefit had been obtained.

The events that could lead to a tax benefit are considered either:

- An incorrect tax return by the registrant.
- A voluntary disclosure by the person or taxpayer of errors in the tax return, tax assessment or refund application.

The tax benefit penalty is calculated as:

- 50% in case no voluntary disclosure is made if a voluntary disclosure is made after being notified of a tax audit and the Federal Tax Authority has started the tax audit process, or after being asked for information relating to the tax audit, whichever takes place first.
- 30% in case a voluntary disclosure is made after being notified of the tax audit and before the Authority starts the tax audit.
- 5% in case a voluntary disclosure is made before being notified of the tax audit by the Federal Tax Authority.

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UAE Cassation Court rules arbitration clause is suspensive condition

May 14, 2021

In March 2021, the highest court in the Emirate of Abu Dhabi, the Abu Dhabi Cassation Court, upheld the denial of the enforceability of an arbitration agreement due to the clause merely stating that arbitration shall be governed by the laws of the United Arab Emirates without explicit scope to any disputes.

The Cassation Court found that the wording of the clause which read “in arbitration, the laws of the United Arab Emirates shall be applied” did not provide sufficient detail to establish the consent of the parties to resort to arbitration as the dispute resolution mechanism.

In its reasoning, the Court found that the wording is to be read as a suspensive condition that would only come into effect should the parties subsequently explicitly agree and establish scope that any dispute shall be resolved through arbitration.

Background

The dispute was in relation to additional works in a construction contract, where the Abu Dhabi Primary Court ruled in favor of the contractor for almost AED 12,000,000 and the Abu Dhabi Appeals Court upheld the contractor’s claim but

reduced the quantum to approximately AED 8,500,000.

Notwithstanding the substantive issues in dispute, here we highlight the significant approach that was taken by the Abu Dhabi Courts and confirmed by the Abu Dhabi Cassation Court, that led to the rejection of the arbitration clause.

Generally, an arbitration agreement should be as detailed as possible to avoid any disagreement over its operation. Such detail would at a minimum include the seat of arbitration, the number of arbitrators, the language of arbitration, governing rules (institutional or ad hoc), and the governing law.

Additionally, parties may at times also apply a governing law to the arbitration agreement separate from the governing law of the substantive contract, identify any matters related to confidentiality, or issues regarding sovereign immunity, amongst other particulars.

The ruling by the Abu Dhabi Cassation Court reflects the importance of clearly drafted arbitration clauses, but the Cassation Court also provides interesting reasoning in finding the arbitration clause merely a suspensive condition in the absence of an explicit agreement that any disputes shall be resolved by arbitration.

Abu Dhabi Appeals Court Judgment

The Abu Dhabi Appeals Court had ruled that the arbitration clause in its wording renders it a suspensive condition requiring the parties to subsequently agree that any dispute shall be resolved via arbitration, at which point such agreement would be governed by the laws of the UAE.

The Abu Dhabi Appeals Court has ruled as follows:

“The appendix of the construction contract between the two parties stipulated in Clause 18 (a) thereof that, in arbitration, the laws of the United Arab Emirates shall be

applied, and it is a text that does not indicate that the two parties have agreed to resolve the dispute through arbitration, but rather is a suspensive condition...

Where the contract provisions lack a requirement to resort to arbitration, and no subsequent agreement to arbitration was made, which means that the current arbitration clause [Clause 18 (a)] is an unfulfilled suspensive condition.”

Abu Dhabi Cassation Court Judgment

The Abu Dhabi Cassation Court relied on Articles 5, 6, and 7 of the Federal Arbitration Law to reason that the wording of the clause does not evidence the parties’ explicit agreement to resort to arbitration to resolve any disputes.

The Abu Dhabi Cassation Court upheld the Appeals Court judgment, and ruled as follows:

“Whereas the decision was made in the jurisdiction of this court – and in accordance with Articles 5, 6, and 7 of the Arbitration Law – for the court to reject its jurisdiction on a dispute requires the existence of an arbitration clause to evidence that the parties have agreed in writing to resort to arbitration as an exceptional means to settle disputes between them, whether through a special clause in the original contract or via an agreement independent of the main contract, given that the consent of the parties is the basis of arbitration and that the arbitrator derives their authority from the contract in which the arbitration was agreed upon.

Therefore, the judge must verify that the will of the litigants matches the agreement on arbitration and the underlying dispute, and the interpretation of the contract to identify the intent of the parties is the authority of the trial court...

...the clause subject of dispute in the contract states (governing law: the laws of the United Arab Emirates shall

govern arbitration) and hence does not disclose the parties' express will in the agreement to resort to arbitration..."

Significance

This judgment by the Abu Dhabi Cassation Court highlights the extent to which the Courts will investigate – not only the existence of an arbitration provision – but the precise wording and scope of the arbitration clause. The approach confirmed by the Abu Dhabi Cassation Courts emphasizes the need for parties to ensure a clear scope of applicability to their arbitration clauses.

Importantly as well, the UAE Courts generally find an arbitration clause binding or non-binding, but seldom has a UAE Court ordered an arbitration clause to be considered a suspensive condition; which is a condition that suspends the effect of a clause until a future event occurs or is realized.

The UAE Courts have previously ruled on the necessity to comply with pre-conditions to arbitrate, however considering an arbitration clause a suspensive condition raises questions as to the threshold that the courts require to accept that an arbitration agreement is fulfilled.

Essentially, finding that an arbitration agreement could be deemed a suspensive condition unless the parties explicitly state that any dispute (or a particular dispute) shall be resolved by arbitration means that arbitration agreements could include minimum standards as detailed above – such as language, number of arbitrators, rules, etc. but could nevertheless be deemed a suspensive condition in the absence of an explicit agreement that disputes shall be resolved via arbitration.

Moreover, this judgment creates a novel paradigm in regards to the separability of an arbitration agreement and acknowledging an arbitration agreement, yet considering it suspended.

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New Dubai Tax Dispute Resolution Committees now deciding on 2020 and 2021 objections

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Brief

Since around September 2020, the tax dispute resolution committee of the Emirate of Dubai has been inoperable (under reformation).

On 25 November 2020, the UAE Minister of Justice issued Ministerial Decree No. 691/2020 on the Formation of Tax Dispute Resolution Committees for the Emirate of Dubai.

The Emirate of Dubai previously had only one tax dispute resolution committee to hear objections against reconsideration decisions of the Federal Tax Authority. However, the Decree formed two tax dispute resolution committees for the Emirate of Dubai (Dubai TDRCs).

The two new Dubai TDRCs began practically operating on 16 February 2021 and had docketed all tax objections lodged in 2021 for review and issuance of a decision.

Decisions for objections filed in 2021 have begun being issued as of mid-March 2021.

As of the fourth week of March 2021, objections filed in 2020 are also being considered by the Dubai TDRCs.

However, taxpayers could be required to communicate with the Ministry of Justice and confirm the validity of the objections and continued request by the taxpayer/objector for the Dubai TDRC to decide on the objection.

The Ministry of Justice may request confirmation as to whether the objector had proceeded to file an appeal before the Federal Primary Court pursuant to Article 33(2)(b) of the Tax Procedures Law which grants objectors the opportunity to challenge the non-issuance of a decision by a tax dispute resolution committee.

(The Tax Disputes Circuit of the Federal Primary Court is responsible to hear challenges against rulings of a TDRC. Both the taxpayer and the FTA may challenge a ruling of the TDRC before the Federal Primary Court, Federal Appeals Court, and finally the Federal Supreme Court.)

Timelines

If a person (domiciled in Dubai for tax purposes) disagrees with a decision by the FTA and commences the reconsideration process but does not obtain a favorable outcome, the subsequent procedure would be to object before the Dubai TDRCs.

The objection is lodged with the tax dispute resolution department of the Ministry of Justice that is responsible for lodging the objection with the Dubai TDRCs within two weekdays

as of the date of the filing.

Once the Dubai TDRCs receive the objection, a decision must be rendered within a maximum of forty weekdays which comprises of an initial twenty-weekday period and an additional twenty-weekday extension period. The extension can be granted based on the request of the objector or the Federal Tax Authority, or if the Dubai TDRC deems it necessary.

After the procedure before the Dubai TDRC is concluded, either the objector or the Federal Tax Authority can challenge the committee's decision before the Federal Primary Court.

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Dubai Cassation Court rules FIDIC arbitration clause not enforceable

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In a recent judgment, the highest Court in Dubai, the Dubai Cassation Court ruled that incorporating a FIDIC contract (general conditions) by reference into a transaction does not necessarily bind the parties to the arbitration clause therein that FIDIC contract (general conditions).

In this judgment, the Dubai Cassation Court also sheds light on the judicial approach with respect to Article 7(2)(b) of the Federal Arbitration Law which permits incorporating arbitration clauses by reference to any model contract, international agreement, or any other document containing an arbitration clause.

The dispute involved matters related to variation, site discharge, termination for convenience, and other issues related to the construction of a villa. The dispute quantum was around AED 20,000,000.

The employer sued the contractor before the Dubai Primary Court, which found that the Dubai Courts have jurisdiction over the dispute, and ruled in favor of the employer.

The contractor appealed and the Dubai Appeals Court ruled that the Dubai Courts do not have jurisdiction over the dispute due to the existence of the arbitration clause that is incorporated by reference between the parties.

The parties had indeed agreed that the 1987 FIDIC Red Book General Conditions of Contract shall govern the transaction.

Clause 67 of the 1987 FIDIC Red Book General Conditions contains a multi-tiered dispute resolution clause which requires that all disputes are to be referred to the engineer in the first instance for a decision and subsequently to arbitration under ICC rules.

The Dubai Appeals Court found that incorporating by general reference the entirety of the 1987 FIDIC Red Book General Conditions is sufficient to bind the parties to the arbitration clause contained therein the General Conditions.

The employer challenged the Dubai Appeals Court judgment before the Dubai Cassation Court.

The Dubai Cassation Court overturned the Appeals Court

judgment and found that the arbitration clause was not enforceable and that the Dubai Courts had jurisdiction to adjudicate the dispute.

Referring to statute; the Cassation Court relied on Article 7 of the Federal Arbitration Law which requires arbitration agreements to be in writing. Although the judgment references the entirety of Article 7, the judgment continues to implicitly highlight the provisions of Article 7(2)(b) by elaborating on the permissibility of incorporating an arbitration clause by reference in a written contract to any model contract, international agreement, or any other document containing an arbitration clause if the reference is such as to make that arbitration clause part of the contract.

The parties did indeed agree that the 1987 FIDIC Red Book General Conditions shall govern the transaction, however, the Cassation Court found that because there was no explicit reference to the arbitration clause of the General Conditions, it cannot be construed that the parties had explicitly agreed to the arbitration clause therein.

The Dubai Cassation Court upheld the Dubai Primary Court's reasoning, which provided a more in-depth analysis, as follows:

“An agreement to arbitration is considered when it is a referral contained in the original contract to the document that includes the arbitration clause if the referral is clear and explicit in adopting this condition, and the effect of the referral is only achieved if it includes an indication to the arbitration clause included in the document referring to it, yet if the referral to the aforementioned document is merely a referral in general for the texts of this document without specifying the aforementioned arbitration clause in particular that establishes the parties' knowledge of its existence in the document, the referral does not extend to such arbitration clause, and the arbitration is not deemed agreed upon between

the parties to the contract, and it is also decided that if there are appendices or schedules to the contract, it is not required that the parties sign them if the parties stipulate in the contract that these appendices or schedules are considered an integral part of the contract, considering that these appendices or schedules are nothing more than a detailed statement of what the parties have agreed in substantive issues, except that if these appendices or schedules include an exceptional condition such as the arbitration clause, which does not apply to the parties, unless signed by the parties...the contract concluded between the plaintiff and the defendant which governs the relationship that is the subject of the lawsuit does not evidence the will of the parties to bring into effect the arbitration clause to settle the disputes arising from the implementation of the contract.”

A special webinar has been prepared to discuss this judgment in collaboration with the Chartered Institute of Builders, which will take place on 19 April 2021. For more details and registration [click here](#).

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UAE Supreme Court Rules No Privacy Invasion via WhatsApp

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The case involved a husband (the defendant) who took a video of his wife (the complainant) and sent the video recording to the complainant's mother instantaneously through the instant messaging application; WhatsApp.

The complainant/wife filed a criminal complaint against the defendant/husband for breach of Federal Decree-Law No. 5/2012 on Combating Cybercrimes (the "Cybercrime Law") which prohibits the use of a computer network or electronic information system or any information technology means for the purpose of the invasion of privacy.

The complainant/wife requested that the defendant/husband be penalized under Article 374/1 of the Penal Code and Article 21 of the Cybercrime Law. (Citations provided below.)

Amongst the requests by the complainant for the judiciary to order a fine against, and the imprisonment of the defendant, the complainant also requested an order for the prohibition of the defendant to access WhatsApp and the telecommunication network used by the defendant in the purported crime.

The complaint was first filed in mid-2017, with the final and binding ruling being issued by the Federal Supreme Court in mid-2019.

It is was decided by the Federal Supreme Court that invasion of privacy crimes committed through WhatsApp are not covered by the Cybercrime Law if the crime involves two or more persons in a closed room with the subject matter and media not privy to others outside that room.

The court did not rule on whether there were breaches under the Penal Code as the limitation period of three months on insult and slander accusations had expired by the time the complaint was filed.

In this ruling the Federal Supreme Court sets two elements to the test of whether the privacy of another person has not been

invaded via electronic/digital means:

- Outside of cyberspace, if the accused, the suggested victim, and the recipient(s) of the media purported to have invaded the privacy of another, are physically located in a place closed-off to others; and
- If the media purported to have invaded the privacy of another is distributed only to persons in the same closed-off venue, who are also privy to the subject matter of the distributed media.

In the Workplace

The ruling raises questions towards the applicability of the Cybercrime Law in a workplace environment.

Comparatively, if this ruling were to be used as reference in managing workplace privacy policies, then it is arguable that a recording/image of one employee shared amongst other employees may not necessarily fall under the Cybercrime Law's invasion of privacy provisions if said employees are all within a closed-off area (a closed office space for example) at the time, and the media is not distributed to persons outside that closed office space.

Provisions

- Article 21 of the Cybercrime Law:

Shall be punished by imprisonment of a period of at least six months and a fine not less than one hundred and fifty thousand dirhams and not in excess of five hundred thousand dirhams or either of these two penalties whoever uses a computer network or and electronic information system or any information technology means for the invasion of privacy of another person in other than the cases allowed by the law and by any of the following ways:

1- Eavesdropping, interception, recording, transferring,

transmitting or disclosure of conversations or communications, or audio or visual materials.

2- Photographing others or creating, transferring, disclosing, copying or saving electronic photos.

3- Publishing news, electronic photos or photographs, scenes, comments, statements or information even if true and correct.

Shall also be punished by imprisonment for a period of at least one year and a fine not less than two hundred and fifty thousand dirhams and not in excess of five hundred thousand dirhams or either of these two penalties whoever uses an electronic information system or any information technology means for amending or processing a record, photo or scene for the purpose of defamation of or offending another person or for attacking or invading his privacy.

▪ Article 374/1 of the Penal Code:

Shall be sentenced to detention for a maximum period of six months or to a fine not exceeding five thousand dirhams in case the libel or insult takes place through the telephone or facing the victim in the presence of others.

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Q&A: Labor and Employment

Laws in the UAE

May 14, 2021

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UAE Supreme Court rules late payment penalties apply to voluntary tax disclosures

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Issue

The first case involving the method of calculating late payment penalties on voluntary disclosures has been adjudicated by the Federal Supreme Court.

The Federal Supreme Court has taken a position divergent from that of the tax dispute resolution committees, and the Federal

Primary and Federal Appeals Courts on this matter.

The judgment is significant because late payment penalties are calculated at a maximum of 300% of the tax debt.

A voluntary disclosure is when a taxpayer notifies the Federal Tax Authority ("FTA") of an error or omission in a previous tax return, tax assessment or tax refund application.

A voluntary disclosure is obligatory when the taxpayer discovers a mistake – and submission of the voluntary disclosure must be made within twenty weekdays of discovering the mistake.

Once the taxpayer makes a voluntary disclosure – the resulting late payment penalties can reach a maximum of 300% of the disclosed amount calculated retrospectively as of the original tax return, tax assessment, or tax refund application.

Voluntary disclosure penalty calculation

The voluntary disclosure results in the FTA applying fixed penalties that comprise of AED 3,000 for the first time, and AED 5,000 for each subsequent voluntary disclosure.

A voluntary disclosure also results in the FTA applying a percentage-based penalty of 5% calculated based on the tax amount variance between the value in the voluntary disclosure and the original tax return, tax assessment, or tax refund application. This is referred to as a 'tax benefit' penalty.

Thirdly, the FTA generally applies a late payment penalty to voluntary disclosures at 2% immediately, 4% after the first week, and 1% daily up to a maximum of 300% calculated retrospectively as of the date of the tax return, tax assessment, or tax refund application that is being remedied – not as of the date of the voluntary disclosure.

Federal Supreme Court judgment

The case involved the application of late payment penalties on voluntary disclosures.

Since early 2019; the tax dispute resolution committees, the Federal Primary Court and the Federal Appeals Court, have taken the position that late payment penalties do not apply to the tax amount variance between the voluntary disclosure and the original tax return.

In other words – that the late payment penalties should be calculated as of the date of the voluntary disclosure, but not retrospectively as of the date of the original tax return.

However, the Federal Supreme Court has taken a position divergent from that of the tax dispute resolution committees, and the Federal Primary and Federal Appeals Courts.

The Federal Supreme Court reasoned that voluntary disclosures are to be considered a branch of the original tax return.

Based on this reasoning, the Federal Supreme Court ordered that late payment penalties should apply retrospective to the voluntary disclosure, calculated as of the date of the original tax return.

For example, if a person discovers a mistake in a tax return from April 2018, and makes a voluntary disclosure in April 2020, the late payment penalties up to 300% would be calculated as of April 2018 – not April 2020.

Article 101 of the UAE Constitution states that the judgements of the Federal Supreme Court shall be final and binding upon all. Thus, it is expected that the tax dispute resolution committees, and the Federal Primary and Federal Appeals Courts shall echo the position taken by the Federal Supreme Court on this issue.

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Tax Trials & Construction Disputes: Considerations of VAT on Liquidated Damages (UAE)

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VAT on Liquidated Damages

Construction litigation is generally segmented into two claims. The first is a claim for sums that are due but unpaid, whether contractually or on *quantum meruit* basis, generally for a transaction which has concluded. The second type of claim is compensation for a transaction that has not taken place, i.e. no underlying service or good has been provided.

In respect of the second type of claim, the UAE Civil Transactions Law permits the parties to set a compensatory amount for liquidated damages. Notwithstanding, the law also permits a court “...at the request of one of the parties, amend such an agreement, in order to make the amount assessed equal to the prejudice.”

Often before a competent court or an arbitration tribunal, litigants trigger the right to reassess compensation for liquidated damages which entails various applications, hearings, pleadings, and expert work that litigants should

manage efficiently for any subsequent VAT liability concerns or tax trials.

The UAE Federal Tax Authority's public clarification on the matter titled 'VAT treatment of compensation-type payments' explains that liquidated damages for loss of earnings – not for the provision of any goods or services – are outside the scope of VAT.

In its public clarification, the Federal Tax Authority describes 'liquidated damages' as *"predetermined amounts that contractual parties designate during the formation of the agreement for the injured party to collect as compensation upon a specific breach – for example, in case of early termination of a contract or performance delay. The purpose of such payments is not to provide consideration for a provision of any goods or services but to compensate a party for loss of earnings. As such, the payments are outside the scope of VAT."*

Litigation Considerations

The litigation commences with the dispute notice which sets out the allegations that create the basis for the claim. In this sense, the notice describes the allegations and heads of damages, it is a considerable piece of evidence to determine the taxation treatment of the construction dispute proceeds received, and any expenses that may be incurred.

The complaint then materializes into a construction dispute before an arbitration tribunal or competent court and may have consequential effects in a subsequent tax trial before any of the Abu Dhabi, Dubai, or Sharjah tax dispute resolution committees, or before the tax disputes circuits at the federal courts.

With VAT liabilities in mind, litigants should maintain a holistic approach during submission of documentation in a construction dispute to ensure that the segmentation of the claims allows for determination of the tax treatment of the

moneys that will ultimately be awarded.

Ultimately, the judgement or award issued in the construction dispute may or may not specifically allocate the award moneys clearly and consequentially hinder a litigant from identification of the tax treatment that should apply. Litigants should be vigilant in their analysis of how the judgement or award is detailed and follow any necessary applications before the courts or arbitration tribunal to obtain evidentiary documentation of how the awarded moneys are allocated.

Set-Off / Nomenclature

The respective public clarification by the Federal Tax Authority explicitly considers and elaborates on nomenclature in determining whether a payment is consideration for a supply or not. The public clarification states verbatim that *"...it is important to ignore the labels or titles the parties give to a payment."*

For employers, this should be accounted for where the employer is the recipient of liquidated damages and applies rights of set-off. Although the treatment of liquidated damages would be outside the scope of VAT, employers must account for potential VAT liability in cases where payment of liquidated damages by a contractor are set-off against contractor invoices.

Evidence

Upon receipt of the judgement or award, the taxpayer (e.g. the contractor) will determine the tax treatment that shall be applicable to the moneys awarded. The treatment should be in line with the Federal Tax Authority's public clarifications and general tax legislation. Article 48 of the Tax Procedures Law places the burden of proof on the taxpayer to evidence the justification of the tax treatment.

Litigants would be prudent in considering the tax treatment of

the ultimate judgement (or award) at the outset of the litigation and plan accordingly, with tax litigation expertise involved in the case management process, in case of a potential subsequent tax trial.

The outcome of the construction dispute will also provide evidence on whether the compensation can be attached to an underlying service or good – even if they are considered liquidated damages by the parties – at which point a VAT liability may be incurred (such as the case of set-off rights noted above).

The taxpayer will have to evidence that the moneys received are indeed compensatory in nature for liquidated damages before the Federal Tax Authority, or a tax dispute resolution committee, or the federal courts, in a potential tax trial.

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