Ruling Sets Precedent on Applicable Penalties for Voluntary Tax Disclosures (UAE)

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In the extremity; when faced with errors in tax filings, taxable persons may be subject to fines amounting to the equivalent of up to 350% of any unpaid taxes.

Comparatively, with appropriate record-keeping and diligent filing of a voluntary disclosure(s), the penalty that could apply to errors would only be 5%, as supported by a recent ruling of one of the three Tax Dispute Resolution Committees (TDRC) in the United Arab Emirates.

Taxable persons wishing to notify the Federal Tax Authority (FTA) of an error or omission in their tax return, tax assessment, or tax refund application may submit a voluntary disclosure pursuant to Article 8 of the Executive Regulations to the Tax Procedures Law.

There have been cases of voluntary disclosures that have resulted in penalties specific to voluntary disclosures being applied to the taxable person amounting to 50%, 30%, or 5% of the unpaid tax.

There have also been cases where voluntary disclosures have resulted in the taxpayer being subjected to retroactive penalties that would amount to a maximum of 300% of the unpaid tax in addition to the 50%/30%/5% voluntary disclosure penalties.

A recent landmark ruling by the Tax Dispute Resolution

Committee (TDRC) clarified that where the taxpayer can clearly evidence that they have acted in good faith and made the voluntary disclosure within the timeframe of twenty business days as of the date their awareness of the error, only the voluntary disclosure penalties apply – and not the retroactive penalties that could amount to an additional penalty of 300% of the unpaid tax.

As opposed to merely stating the necessity to remedy a mistake without noting the taxable person's consciousness of the error; both the Executive Regulations and the Tax Procedures Law emphasize the element of a taxable person's awareness of a mistake when making a voluntary disclosure filing:

- Article 8 of the Executive Regulations: "*…the taxable person shall make a voluntary disclosure to the Authority within twenty business days from the date when the taxable person became aware of the error.*"
- Article 10 of the Tax Procedures Law in each of the four sub-articles: "*If a taxable person becomes aware…*"

The TDRC's ruling is in line with UAE court precedent such as the Federal Supreme Court's rulings in appeals 555/2012 and 1/1991 where the Court clearly indicated that unintentional error is not punishable especially if the subject person acted in good faith [when becoming aware of a mistake] within the parameters of the law.

The significant takeaway of this ruling for taxable persons is that evidence of how the error and/or omission came about, and how the taxable person became aware should be clearly recorded and transmitted to the FTA when a voluntary disclosure is made. That evidence should indicate that the taxpayer had discovered the error (and made the voluntary disclosure) within the twenty-business day period.

When reconsideration requests to the FTA are made, challenges before the TDRC are submitted, or an appeal is raised before

the Federal Courts on voluntary disclosure, it is paramount that the taxable person can clearly evidence how it is they came about becoming aware of the error that required a voluntary disclosure.

Such evidence can be in the form of internal communication between personnel, private clarifications (a response to a clarification request issued to the FTA), issuance of an FTA guide or public clarifications, adjustment of systems and processes (especially in light of the novelty of the tax reforms in the UAE), deployment to production systems, internal audits, and so on.

The Penalties in Detail

Cabinet Resolution No. 40/2017 on Administrative Penalties for Violations of Tax Laws in the UAE explicitly provides for the application of two penalties in cases of voluntary disclosure by the taxable person. The first is a fixed penalty of AED 3,000 for the first occurrence of voluntary disclosure and an AED 5,000 penalty in case of repetition.

If the taxable person makes a voluntary disclosure after being notified of the tax audit and the FTA starts the tax audit, or after being asked for information relating to the tax audit, whichever takes place first, a 50% penalty of the unpaid tax shall apply.

If the taxable person makes the voluntary disclosure after being notified of the tax audit but before the start of the tax audit, a 30% penalty of the unpaid tax shall apply.

If the taxable person makes a voluntary disclosure before being notified of the tax audit by the FTA, a 5% penalty of the unpaid tax shall apply.

Nonetheless, there are also additional penalties that have been imposed on taxable person retroactively when voluntary disclosures are submitted to the FTA. These penalties have

been those that fall under the category of failure to settle the tax within the timeframe (i.e. late payment penalties). These penalties are:

- 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 a maximum of 300%.

The calculation of the above late penalty percentages commences as of the date of when the disclosure should have been made initially (i.e. when the error occurred).

Knowledge of Tax Legislation

In a short period of time, the UAE witnessed several federal legislations (laws, legislative decrees, cabinet decisions, ministerial decrees, all of which comprise new tax legislation). This legislation is new to the community and the Emirati judiciary and came in succession rapidly. Moreover, there have been more than 20 guidelines and 10 public clarifications issued by the FTA.

Albeit the general principle is that ignorance of the law is not an excuse; it is in UAE jurisprudence that it is necessary for those subject to the law to understand the content and application of the law as an additional condition after its publication and entry into force. This is pursuant to the principles of justice that a person is required to respect legislation only after he or she has become aware of its requirements.

This axiom is significant for taxable persons who see a voluntary disclosure triggered due to new guidelines or public clarifications issued by the FTA, private clarifications provided, or errors that stem from the organizational

compliance efforts that a taxable person puts in place to comply with the tax reforms.

In 2008, the Federal Supreme Court ruled that the general constitutional requirements and the legal system are based on the principle that laws and the like are not enforced once they are enacted, but must be sufficiently communicated to all and brought to their knowledge. Otherwise, the adverse would be contrary to the principles of justice and the obligation to protect acquired rights, and the stability required by the public interest in the transactions of individuals and maintenance of public confidence.

The Federal Supreme Court ruled in the same manner in 2002 that in accordance with the principles of the Shari'a law, the general constitutional principles and the foundations of the legal system, it decided laws and the like (regulations, etc.) shall not be effective once issued, but shall be communicated to all and brought to their knowledge in order for those subject to the law to conform to.

The principles of knowledge of the law – particularly in tax legislation – have also been grounded by the Egyptian Court of Cassation in a recent ruling in 2016 where the Court found that late payment penalties due to the introduction of new tax legislation should be reconsidered by the respective authorities, and in certain cases, not be applied due to the time period necessary for a taxable person to become aware of the new tax requirements.

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