
UAE Public Finance Review 2010

Abstract

This article reviews and analyses the structure of taxation, the composition of public finance revenue and expenditure, and the levels of sovereign debt in the United Arab Emirates (UAE). It examines the debt market during the economic boom years and the 2007-2010 financial market turmoil, reviews the role of government related entities, and explains the relation between an efficient legal framework and the development of a healthy debt market. It concludes with a review of the repercussions of these changes and the socio-economic impacts. The examples used are based on the financial structure of one of the seven Emirates – Dubai. Singapore example is used to provide comparable example to Dubai's public finance development.

For any enquires please contact: Ionna Trofimova, Head of Research. E-Mail: ionna@oryxme.com

Tax heaven

UAE's high oil revenues have influenced the non-requirement of income through direct taxation in the past. Accordingly, UAE is a 'tax free' country characterized by a very low level of taxation.

There is no personal income tax or corporate tax, excluding petroleum companies and foreign banks, which are subject to taxation. The profit rate for branches of foreign banks is 20%, and insurance companies are obliged to pay 0.2% as a turnover tax. Property leases and hotels are subject to municipal taxes. The Dubai government increases its revenue by various service fees and charges, for example, a 5% annual rent charge.

The state's budget is largely dependent on oil reserves, production and prices, a condition which is unsustainable without long-term sources of tax and other revenues. Consequently, the introduction of a property tax and expansion of the corporate tax across all industries is required for long-term sustainability of a country.

In August 2005, the UAE was reviewing the possibility of the introduction of a national sales tax, and the UAE authorities employed sources to help develop a Value Added Tax (VAT) system.

The introduction of VAT should result in diversification of the fiscal base, which is now highly reliant on oil & gas revenues. VAT is expected to be introduced to replace currently existing custom duties. The removal of custom duties is a key requirement for free trade agreements with many states, notably the US (United States), EU (European Union), India and China. The main advantage of the introduction of VAT is its positive effect on federal revenues. However, a proposed VAT of 3% would be the same as the customs duties levy on imports today. Customs duties account for only a minor part of federal income, 3.5% of total fiscal revenue in 2007. However, oil & gas revenue accounted for 77% of total fiscal revenue. Hence, in order to reduce the oil & gas proportion of the fiscal income, the VAT rate should be well above the currently proposed rate of 3%.

Taxation has become an indispensable part of the modern economic system worldwide, and there are a wide variety of tax models with different policies, regulations, and collection systems that governments can choose from. A lack of proper VAT planning and implementation in countries like Belize, Ghana, Malta and Vietnam has meant that they have had to recreate their VAT systems. This highlights the vital importance of proper planning before VAT is introduced in the UAE and the Gulf in general.

VAT is a major development in the UAE. In the long term, VAT will result in increased non-oil fiscal income and improved financial regulation and reporting transparency, and it will also change the UAE's image and role as a 'tax haven'.