Profit Margin Scheme: Where to start and how to apply correctly

The Profit Margin Scheme is an optional method of tax calculation, where the taxable person calculates the VAT on the profit instead of the sales value. The method is applicable to select type of goods under specific circumstances. Profit Margin is defined as the difference between the purchase price and the selling price of the good. Tax payer may choose this method at any point where all the required conditions are met.

Eligibility for the Scheme

When it comes to determining whether you are eligible to apply the profit margin scheme, we suggest using the following nominal tests.

- The good's test

The first test can be used to determine whether purchased goods falls under one of the following criteria:

- Second-hand goods which are tangible, movable, and can be used further. As an example, a used car can fall under this criterion;
- Antiques – goods which are more than 50 years old;
- Collector's items: such as stamps, coin, currency or other pieces of scientific, historical or archaeological interest.

- The supplier's test

Using the second test, a business shall ensure whether the seller of purchased goods is either:

- Non-Taxable Person (e.g. individual);
- Taxable Person who has already applied the profit margin scheme on the same purchased goods;
- Taxable Person who has not recovered input tax in respect of the purchase of the same goods. It can be the case where the Taxable Person purchased a car for use in the business, however, the car has been available for personal use by any person.

- The VAT liability test

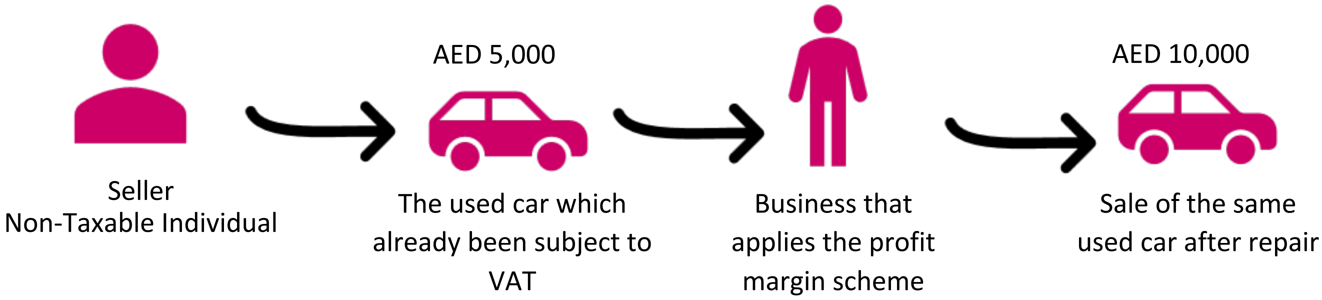
At this stage, it is essential to determine whether the purchased goods were subject to VAT before the current supply. Considering that the effective date of VAT implementation in the UAE was the 1st January 2018, goods purchased prior to this date are not eligible in the profit margin scheme. Therefore, it is advisable to obtain a copy of the tax invoice relating to the original purchase of the goods to determine whether the goods can be subject to the profit margin scheme.

Accounting requirements for the profit margin scheme

If the business has answered 'Yes' to all the above, the business may apply the profit margin scheme and follow the appropriate accounting treatments in compliance with UAE VAT legislation.

Based on our VAT experience in the UAE and KSA, Rethink's team has prepared a scenario of the profit margin scheme and required steps for correct implication as follows:

Scenario:



Step 1. Calculation of Profit Margin

As mentioned above, the Business shall calculate the profit margin based on the difference between the purchase price and the selling price of the same goods as follows:

The Profit Margin = The Selling price AED 10,000 – The purchase price AED 5,000 = AED 5,000.

Moreover, according to UAE VAT Law, the profit margin shall be inclusive of VAT. Therefore, the Business shall perform the following calculation in order to identify VAT Amount:

VAT Amount = AED 5,000/21= AED 238

Step 2. Invoicing

The Business engaging the profit margin scheme shall issue a Tax Invoice inclusive of VAT which states that VAT was charged with reference to the profit margin scheme. There is no need to separately identify the VAT as is the case in normal supply of goods.

Taxable Person who applies the profit margin scheme shall obtain a purchase invoice showing details of the purchased car. Where the used car is purchased from the non-registered seller, the business must issue an invoice showing details of the used car himself, and request for the seller's signature.

Step 3. Record keeping

According to UAE VAT Law, the business that applies the profit margin scheme shall keep the following records in respect of such supplies for a minimum of 5 years after the end of the tax period to which they related:

- A stock book, or a similar record showing details of each good purchased and sold under the profit margin scheme;
- Purchase invoices showing details of the Goods purchased under the profit margin scheme.

Additionally, the FTA has suggested keeping evidence, or information of previously paid tax by a seller in respect of purchased goods. Therefore, it is advisable to obtain either a confirmation of paid tax in a written form or a copy of the tax invoice relating to the purchase of the goods.

Way forward

Considering that the applicability Profit Margin Scheme is restricted taxpayers are recommended to look into the following:

- Evaluate your eligibility to participate in the Scheme.
- Maintain the required documentation.
- Educate the staff on the applicability and benefits of the Scheme.
- Regularly submit the VAT returns without any delay.

How can we help

Re/think as an entity provides VAT advisory, optimization, registration, implementation, compliance and training services in the UAE and the GCC. Before you reach your VAT filing due date, contact us for a VAT Health Check and VAT filing assistance.

Our team is here to guide you through the VAT law and regulations and ensure full compliance with the law.

Our team of senior qualified tax advisors, finance experts, and tax accountants will ensure timely and cost-effective VAT services for SMEs.

Based on our local and international experience we understand that VAT is a complex tax and will certainly suffer numerous changes in the upcoming years. Rethink’s VAT services are aimed to suit both basic and complex returns for SMEs and larger enterprises.

Who we are

Re/think is a boutique accounting, audit, VAT advisory, compliance, HR consultancy and CFO business advisory firm with offices in Dubai, Abu Dhabi and Bahrain, focused on providing entrepreneurial businesses of varying sizes with timely, proactive and customized business solutions from start-up and early development to the latest stages of a business lifecycle.