

MAJOR DEVELOPMENT IN THE UAE TAX LITIGATION LANDSCAPE: UAE Supreme Federal Court rules the application of late payment penalties in addition to voluntary disclosure penalties to voluntary disclosures (Detailed Reasoning)

On 14 October 2020, the UAE Federal Supreme Court passed its judgment on an appeal filed by the UAE Federal Tax Authority (FTA) in relation to the Court of Appeal's judgment **concerning the imposition of penalties resulting from a voluntary disclosure**. The case was handled by a UAE local law firm on behalf one of the UAE's largest financial institutions.

The Court of Appeal's decision had followed the established position (since the beginning of 2019) that the UAE Tax Procedures Law distinguishes penalties for late payment of tax as shown in submitted returns or notified assessments, from fines and penalties applicable to voluntary disclosures.

However, and in a very significant twist, the UAE Federal Supreme Court took a different position and decided the following:

- i. Late payment penalties should also apply to voluntary disclosures (up to 300% of the tax due);
- ii. Late payment penalties apply from the due date of the tax return and not from the date of the voluntary disclosure; and
- iii. The voluntary disclosure penalties specified under Item 11 of the Schedule of Penalties attached to the Cabinet Resolution No. 40 of 2017, apply to voluntary disclosures (in addition to late payment penalties: 50% or 30%, or 5% of the tax due (depending on the timing of the submission of the voluntary disclosure)).

For ease of reference, the full reasoning of the Court is set out in the Annex hereto.

In brief, based on this judgment, taxpayers submitting voluntary disclosures could be subject to penalties of up to 356% of the tax due. The Federal Supreme Court's judgment reverses the position that had been established over the past 18 months, by virtue of which the penalties payable by taxpayers had been adjudged by the Courts to be limited to administrative penalties as mentioned in point (iii) above. The Federal Supreme Court takes the view that voluntary disclosures are merely amended tax returns in nature.

It is also worth noting that the Federal Supreme Court's judgement also decided "*to refer the lawsuit to the Abu Dhabi Federal Court of Cassation for adjudication de*

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novo (anew) with a different panel". We will be keeping an eye on how the Court of Appeal is going to handle the case based on the Federal Supreme Court's direction.

This is a major development in the UAE tax landscape, as the Federal Supreme Court's judgment may affect upcoming decisions to be issued by the various Tax Dispute Resolution Committees (**TDRC**) and Federal Courts. We expect that this judgment will have a significant impact on critical business sectors involved in transactions in respect of which the interpretation of Value Added Tax (**VAT**) or excise tax under the UAE law and regulations is at best unclear and uncertain, resulting to huge financial exposures.

The UAE Constitution states that Federal Supreme Court judgments are binding and conclusive. However, this does not preclude the Federal Supreme Court's position to change or offer more flexibility in the interpretation/application of certain law provisions.

This latest judgment confirms the necessity for taxpayers to adequately consider appropriate strategies to adopt before or when pursuing tax challenges before the TDRC and Federal Courts. We are happy to support you throughout the challenge process in relation to your tax dispute and litigation matters. For further information, please contact [Mohamed El Baghdady](#) and [Reggie Mezu](#) of the UAE Tax team.

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Annex (Non-Official Translation)

Whereas the Appellant challenges the contested judgment in terms of its misapplication of law, deficiency of causation, flaws of reasoning and prejudice to right of defense that it has ruled that the lawsuit is dismissed on the grounds that legislation has limited the delay penalty— in case that the taxpayer has failed to pay the due tax on the scheduled date – for the tax mentioned in the declaration, rather than the difference in tax stated in the voluntary disclosure for which there are no due delay penalties, and that the conclusion reached by the judgment is in contravention of the tax provisions concept. That is because the tax originates from the law that created the legal obligation that it must be paid within the period it has set, and that its source is not the declarations, which are merely containers into which such tax is emptied. Moreover, the tax differences mentioned in the voluntary disclosure serve merely remedial of an error of the person who is subject to tax in the original or basic declaration. Thus, the truth of such declaration is considered to be an amendment of the tax mentioned in this declaration; hence, the late payment charge shall be imposed on the difference in the tax mentioned in the voluntary disclosure, as it is the case with the tax stated in the original or basic declaration. This must not be changed by payment of the tax for the voluntary disclosure, considering that such penalty is prescribed for merely submitting this declaration, which is different from late tax payment charge as each penalty imposed has an area of its enforcement. Furthermore, failure to pay the delay penalty for the tax differences indicated in the voluntary disclosure would cause such delay to serve as a pretext for the taxpayer in the unwarranted delay of dues of the Public Treasury, which renders it rescinded.

Whereas such challenge is valid due to the fact that the relationship between the Federal Tax Authority and the taxpayer is not a contractual one, rather it is an organizational relationship that is governed by jus cogens. Therefore, the source of abiding by the payable tax debt is always the law; where if legislation stipulates that tax payment must be made on a specific date, there has become an obligation on the part of the taxpayer to

pay the tax on such date even if the organization of payment of such tax by filing original or ancillary declarations, considering that such declarations are merely executive procedures to fulfill the right of the State to tax that has been created by law, rather than the aforementioned declarations. Moreover, legislation has not attached acquiring the payable tax capacity or status to declaration, rather it added such capacity or status to the tax that is due for payment, according to the definition of the payable tax laid out in Article 1 of Law No. 7 of 2017 regarding Tax procedures, and Article 1 of Law No. 8 of 2017 on the Value Added Tax (VAT).

Accordingly, if legislation has obligated the taxpayer to file a tax return for each tax period and such filing is incorrect, he has to remedy or rectify such error by submitting a voluntary disclosure for the correct tax dues, in accordance with Article 10 of the aforementioned Law No. 7 of 2017. In the two cases, voluntary filing and declaration shall be for the due and payable tax, which requires the imposition of delay penalties as late payment charges, in accordance with clause 9 of table No. 1 that is attached to the Cabinet Resolution No. 40 of 2017. That is not to say that legislation has limited the imposition of the administrative penalty – in case of failure to pay the due tax – to the tax mentioned in the tax filing, rather than the one set out in such voluntary disclosure on the allegation that legislation has not provided for a late payment charge for the delay in payment of the tax differences stated in the voluntary disclosure. That that is because such allegation is a misunderstanding of such voluntary disclosure's nature, which is in fact an amendment of the original or basic declaration. Consequently, its rule shall apply to it – namely the voluntary disclosure - as it is considered to be just a branch of the origin, which is the original or basic declaration, especially that filing and voluntary disclosure are merely executive procedures for payment of the payable tax whose origin is not the voluntary disclosure or filing, rather it is originated from the law that determined it, according to jus cogens.

Furthermore, saying that legislation has singled out a penalty as such for submitting a voluntary disclosure, whereby no other penalties may be imposed for the payable penalty as mentioned in such declaration is another misunderstanding the essence of the aforementioned tax. That is because the imposition of such penalty is prescribed for merely the submission of the voluntary disclosure as such, which is different from the delay penalty in the due tax payment that is mentioned in this declaration to which the late payment charge for the tax included in such declaration shall apply as previously detailed, which means that each penalty has an area of its enforcement and rule that is not mixed with the other. Additionally, stating that failure to impose a delay penalty for the tax mentioned in the voluntary disclosure would give an excuse that voluntary disclosures serve as the frequent tool for disclosure of tax dues. As a result, the State Treasury shall be unjustifiably deprived of the due taxes for a long time until the taxpayer submits the voluntary disclosure on the tax differences. Hence, its payment date shall become subject to a will rather than to the rule of law and in implementation of the same, which is not legally and logically palatable. Based on the foregoing, failure to pay the due tax on its legally scheduled date would make it imperative to charge the legally prescribed delay penalty, whether such taxes are set out in the voluntary disclosure or filing as previously explained.

Whereas the subject of dispute revolves around whether the Appellee Bank is committed to paying a penalty for its delay in the payment of due tax differences mentioned in the voluntary disclosure or otherwise; whereas the Appellant has abided by payment of such delay penalty, considering its payment of a penalty for submission of the voluntary

disclosure would not be complete without payment of such delay penalty for the due tax differences specified in such declaration, according to what has been previously demonstrated. Thus, the challenged decision of the Committee on overturning the contested decision in terms of its part that is pertaining to calculation of delay penalties – for the tax differences stated in the voluntary disclosure – is groundless, where the foregoing shall not be negatively affected by what the Appellee raised that imposing a delay penalty on the taxed stated in the voluntary disclosure the position of the one subject to tax submitting the voluntary disclosure as a guarantee for the State Treasury is worse than the one who has not submitted such declaration in the first place.

That is due to the fact that the voluntary disclosure along with tax differences it contained is not only a guarantee for the State Treasury, but also a means of rectifying the taxpayer's error as such in the declaration – or the result of the tax assessment - ; therefore, the aforementioned had to, in all cases, correct the errors in his declaration for the purpose of maintaining the dues of the State; otherwise, he would have faced the tax evasion offense, which requires his penalization. Therefore, what the taxpayer rectified in the voluntary disclosure is just a rectification of his own error as such, which prevented him from being criminally questioned. Moreover, the foregoing shall not be jeopardized by what was raised by the Appellee that the purpose of voluntary disclosure is not to address the taxpayer's error only, but also to correct the Authorities error once it assesses the tax

That is due to the fact that the purpose of voluntary disclosure is a correction of the taxpayer's error, whether in the declaration as such or the assessment that is based upon his declaration. Since it is in all cases that the error that has been rectified by the voluntary disclosure is attributed to the taxpayer who should be accurate in providing the specific data and information for tax purposes, considering that if the taxpayer had been accurate in the information indicated in his declaration, this would have saved him from making any other errors that were rectified in the voluntary disclosure, whether such errors were in declaration or assessment. As such, this has prompted the legislator to impose an independent penalty as specified by clause 11 of Table No. 1 that is attached to aforementioned Cabinet Resolution on the taxpayer once he submits the voluntary disclosure in all cases.

Whereas all of the foregoing, and the contested judgment is groundless, and as such contested judgment ruled to uphold the judgment delivered by the Court of First Instance that dismissed the lawsuit filed requesting the reversal of this decision. Therefore, the judgment has contravened the law, which requires it to be rescinded, provided that revocation is accompanied by a referral.

FOR THESE REASONS,

The COURT has ruled to quash the contested judgment, ordered to refer the lawsuit to Abu Dhabi Federal Court of Cassation for adjudication de novo (anew) with a different panel, and obligated the Appellee to pay the expenses, and the amount of Two Thousand UAE Dirhams as attorney's fees to the Appellant.