

# VAT alert | Grandfathering

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Many organisations in both Saudi Arabia and the UAE have found implementing VAT within their business far more complex than they originally anticipated – particularly in view of the limited time businesses had to prepare. VAT is complex and it is easy for businesses to fall foul of the very technical provisions in the VAT law and regulations. As a result, many businesses have misinterpreted or misapplied the tax, leaving themselves exposed to assessments and the imposition of penalties by the tax authority.

One common error we have seen in Saudi Arabia is the misapplication of the zero-rating transitional provision in Article 79(3) of the implementing regulations – the 'grandfathering provision' – which permits zero-rating of supplies made under some legacy contracts, subject to strict conditions.

## What are the conditions?

The grandfathering provision states that a supply of goods or services made in respect of a contract which does not anticipate the application of VAT to the supply may be zero-rated by the supplier until the earlier of the time the contract expires, is renewed, or 31 December 2018, provided:

- The contract was entered into before 30 May 2017
- The customer is entitled to deduct input tax in respect of the supply in full or is an eligible person entitled to a VAT refund
- The customer certifies in writing to the supplier that input tax can be deducted or refunded in full

### **All of these conditions must be met.**

However, despite these explicit conditions, grandfathering has been applied where it should not have been. If a business has applied the zero-rate of VAT instead of the standard rate, the Saudi tax authorities are entitled to pursue the supplier for due VAT – often for large sums. This is even before the application of penalties.

## Common misapplications of the grandfathering provisions

### **'VAT-inclusive' doesn't mean 'did not anticipate application of VAT'**

To qualify for grandfathering, a contract must be silent on VAT. GAZT has clarified that any references in a contract to indirect tax or the imposition of taxes generally (not just specific references to VAT) mean businesses cannot apply the grandfathering provision.

If a contract states that the price is inclusive of VAT, indirect taxes or other taxes, the grandfathering provisions cannot be applied. Many businesses seem to have mistakenly assumed a VAT or tax inclusive price means that a contract did not anticipate the application of VAT and so have applied the grandfather provisions incorrectly, leaving themselves exposed to a significant VAT liability in addition to penalties.



Contact us:



**Mubeen Khadir**  
Head of Tax  
mubeen.khadir@keypoint.com  
+973 17206879  
+973 32226811



**George Campbell**  
Associate Director  
george.campbell@keypoint.com  
+973 17206872  
+973 38338641



**Chris Park**  
Senior Manager  
chris.park@keypoint.com  
+973 17206845  
+973 38338634



**Omar Hisham**  
Manager  
omar.hisham@keypoint.com  
+973 17206877  
+973 38338640



**Willem Bam**  
Manager  
willem.bam@keypoint.com  
+973 17206875  
+973 38338649

**'Renewal or expiry' includes amendments, extensions or alterations**

GAZT has also confirmed that the grandfathering rule does not apply where a contract is amended, extended or altered. A relatively minor amendment, such as the parties agreeing to a different price for the supplies under a contract, rules out grandfathering. Even for contracts which otherwise meet all of the conditions for zero-rating, any change to the contract extinguishes any relief from the effective date that change took place and the standard rate of VAT (five percent) must be applied thereafter.

With GAZT taking a strict approach to what may constitute contract renewal or expiry, businesses that have continued to zero-rate contracts which do not qualify for the relief have left themselves exposed.

**No certificate – contract agreed after 30 May 2017**

Some grandfathering 'fails' have been less innocent, such as the failure to obtain correct certification from customers regarding their ability to recover charged tax or zero-rating contracts agreed after 30 May 2017. In these situations, GAZT has been far less sympathetic in its imposition of penalties, viewing such businesses as – at best – careless or negligent. GAZT is also likely to adopt harsher approach if they discover oversights as part of a VAT audit, rather than if a business holds its hands up and declares an error voluntarily.

**Important note**

The information in this document is based on translations of the VAT laws of Bahrain, the United Arab Emirates and Saudi Arabia, the regulations of the UAE and Saudi Arabia, the GCC VAT framework and general VAT principles. It is provided for information purposes only. Any omissions or errors are inadvertent. This document should not be relied upon in making any decisions. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.

**Dealing with errors**

Mistakes are a fact of life, particularly in the early stages of what is a complex new tax for businesses in Saudi Arabia. It is how businesses identify errors and correct mistakes that matters. Businesses should review any 'grandfathered' contracts to ensure that grandfathering has been applied correctly. Where mistakes are identified, it is critical to accurately quantify the error and declare it to GAZT within 20 days of its identification.

While a business will almost certainly still have to pay the VAT that should have been paid to GAZT, a properly drafted plea for mitigation of penalties, a 'reasonable excuse' – if one exists – and evidence of steps taken to prevent any repetition of the error may go a long way to reducing the overall non-compliance bill. Businesses should also recognise that they may be out of pocket – either temporarily until their customer pays them the five percent or absolutely if the VAT cannot be charged to the customer.