

TAX : WHITEPAPER

# ZERO-RATING EXPORTED SERVICES: NARROWING THE SCOPE





In this article Amrita Chandwani and Nishi Jabeen, from BDO's tax team, consider the far-reaching impact of a change to a single word in the UAE VAT Regulations.

The article also covers the Federal Tax Authority's recently released guidance on interpreting the change.



The UAE Cabinet has issued a Decision (No. 46 of 2020) to amend the VAT Executive Regulations. The Decision introduces changes to the zero-rating for services supplied to non-UAE customers.

At first reading, the amendment would appear to indicate a very significant narrowing of the scope for zero-rating. However, on 22 July 2020, the Federal Tax Authority (FTA) published guidance to clarify its view on how the revised Regulation should be interpreted. This suggests a more moderate restriction. This paper explains the change that has been made, our understanding of the FTA's interpretation and highlights areas where there may still be uncertainty.

## Background and summary

The background to this matter can be found in Article 31(1)(a) of the VAT Executive Regulations. This states that an export of certain services can be zero-rated if:

*'..The Services are supplied to a Recipient of Services who does not have a Place of Residence in an Implementing State and who is outside the State at the time the Services are performed..'*

The effect of the Cabinet Decision was to change the definition of 'outside the State' (i.e. outside the UAE) for the purposes of this zero-rating.

Previously, under Article 31(2) the recipient of the service was considered to be outside the State if:

*'..they only have a short-term presence in the State of less than a month or the presence is not effectively connected with the supply..'*

The provision has now been amended to replace the word "or" with the word "and". This narrows the scope because now, when a foreign recipient of services is in the UAE temporarily, both the conditions must be met if the service is to qualify for zero rating.

A strict interpretation of the provision would also mean that if the recipient of the service has any long-term presence in the UAE, it will remove any possibility of zero-rating, even if the presence has no connection with the supply. However, the FTA's clarification confirms that they do not intend to apply the amended Article 31(2) in this way. The clarification includes example scenarios that indicate that, in certain circumstances, zero-rating will be possible if the recipient of services is present in the UAE for longer than a month, provided the presence cannot be seen as the establishment of the recipient which is most directly connected with the supply. The following is an extract from the FTA clarification, on this point:

*'..where the recipient has establishments both inside and outside the UAE and the supply is most closely connected with the non-resident establishment of the recipient, then that non-resident establishment of the recipient will be treated as the location of the recipient for the purposes of Article 31(1)(a) of the Executive Regulation. In such circumstances, the condition that the recipient is outside the UAE would be met even if the recipient also has a UAE establishment..'*



This suggests that the FTA considers the position with regards to businesses with a longer-term presence in the UAE (as well as outside the UAE) is largely as before. This interpretation of the impact on longer-term presence is to be welcomed as it will allow many services to continue to be treated as zero-rated. However, as mentioned above, it is arguably less restrictive than the strict wording of the amended regulation.

## Matters requiring further guidance

Whilst the amendment and FTA guidance is clear in many respects, there is no definition in the Regulations for the terms ‘presence’ or ‘a month’, which in some circumstances, might create uncertainty.

We can assume the test for presence is different, at least in some cases, to a ‘Place of Residence’ as both terms are used separately in Article 31(1). Very broadly, Place of Residence is a term used in the VAT Law and Regulations to cover fixed places of business such as offices and showrooms and the place where the business is legally established (or for an individual, where he or she is normally resident).

Therefore, presence might sometimes refer to individuals linked to a company who are temporarily or permanently in the country. The FTA clarification certainly suggests this might be the case. In some of the examples in the clarification, which apply to corporates, ‘a representative’ visiting the UAE is referred to as creating a presence. However, further guidance would be useful because elsewhere in the clarification, the general approach is to refer to establishments when commenting on corporates.

Some commentators have suggested, that one of the intentions of the change to the Regulations is to prevent zero-rating for recipients that have branches or representative offices in the UAE. That might be the case in part, but the overall impact would appear to be wider than merely branches and representative offices, which would normally be seen as a Place of Residence if the establishment is closely related to the supply, and so would have always prevented zero-rating for some recipients.

Whilst a month is a commonplace phrase, which will not normally cause issues, a definition would be helpful in some marginal situations. For example, is it a calendar month? If not how many days? Do the days need to run consecutively?

One final area of uncertainty is the question of how businesses should deal with services that span the implementation date of this change. For example, a service might have been started before the date the change came into effect but may be finished after the effective date. Alternatively, a tax invoice may have been raised at a time when the former rules were in force but the service is then delivered after the date of the change. It is possible the normal date of supply rules will provide the answer to such questions but formal guidance would be helpful.

It is hoped that in due course, the Federal Tax Authority will provide additional guidance on these matters.



## Businesses impacted

The amendment will mainly impact UAE businesses with customers visiting the UAE for short periods in connection with the supply. But there are also potential implications for businesses that have clients with personnel based permanently, or long-term, in the UAE.

These are very common scenarios for, amongst others, professional services providers, financial services businesses, authorized distributors, marketing and advertising businesses, and businesses with group management functions based in the UAE. In short, any business that makes supplies to overseas customers needs to study the FTA guidance in detail.

For businesses that are potentially impacted by this change there will be additional compliance requirements because it will be the supplier's obligation to establish whether the customer has a presence that will prevent zero-rating. In some cases, that might not be easy to do.

## Comparison with other GCC countries with VAT

It is worth noting that although all GCC countries follow the GCC Agreement on VAT, each country has taken a slightly different approach to this matter.

### The Kingdom of Saudi Arabia (KSA)

The amendment has similarities with the zero-rating conditions in KSA. The KSA VAT Regulations provide that if the customer directly benefits from the services while they are in KSA, through usual residence or temporary presence, then the services cannot be zero-rated. The exclusion covers both short term and long-term presence in KSA.

### Bahrain

The zero-rating conditions under Bahrain VAT state that a customer will not be considered as being present in the country at the time the services are performed if his presence is not mostly connected to the services received. Like KSA, the Bahrain VAT legislation does not differentiate between short and long-term presence.

With this amendment and subsequent clarification, the zero-rating conditions in the UAE concerning presence are now similar to the positions adopted by KSA and Bahrain.



A table summarizing the zero-rating conditions on presence is below. The table is intended for general guidance only. In some cases, there may be small differences in interpretation between each jurisdiction. The details of local practice and guidance therefore need to be taken into account when assessing whether zero-rating is possible. In addition, other conditions may apply.

Presence	UAE	KSA	Bahrain
Short term presence not connected to the services	0%	0%	0%
Short term presence connected to the services	5%	5%	5%
Long term presence which <u>is not</u> seen as the establishment most directly connected to the receipt of the service	0%	0%	0%
Long term presence which <u>is</u> seen as the establishment most directly connected with the receipt of the service	5%	5%	5%

## How can BDO help?

We have a dedicated VAT team that can assist with assessing how these changes affect your business. We can advise on the changes that will be required to ensure compliance, we can assist with customer communication, staff training and, if necessary, can assist with obtaining clarifications and guidance from the FTA.

BDO Chartered Accountants & Advisors  
23rd Floor, Burjuman Office Tower  
Sheikh Khalifa Bin Zayed Road  
Dubai, UAE

Tel: - +971 4 518 6666

AMRITA CHANDWANI  
Assistant Manager  
Tax Advisory services  
Mobile: +971 52 570 1595  
amrita.chandwani@bdo.ae

NISHI JABEEN  
Assistant Manager  
Tax Advisory Services  
Mobile: +971 58 208 2368  
nishi.jabeen@bdo.ae

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