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VAT AND REVERSE CHARGE MECHANISM

RSM

VAT INSIGHTS

VAT and reverse charge mechanism

Reverse charge mechanism concerns the VAT framework relating to service providers and suppliers of goods established outside of the country of the client.

The reverse charge mechanism is a way to simplify trade between implementing States and to comply with the principle of taxation in the State where the consumption takes place.

It consist to shift the tax liability to the client.

Normally, the taxpayer is the vendor or the service provider. Without the reverse charge mechanism, when a supplier has a client in another implementing State he should register for VAT in the State of the client.

At the end of the day, every suppliers will be VAT registered in all the implementing States.

The reverse charge mechanism is there to avoid this heavy burden on all taxpayers of being registered everywhere.

The reverse charge mechanism applies in various cases but always between registered Taxable Persons.

It applies for all the goods purchased and received from another implementing State.

However, in the KSA regulations followed by UAE, the reverse charge mechanism for trade of goods will not apply before the introduction of the Electronic Services System in all Member States. That is to say : nobody knows if it will apply one day.

Concerning the services, it applies for services purchased from suppliers located outside of the State of the client, in or out of the GCC territory.

However, for services with specific place of supply indicated in the articles 18 to 21 of the GCC VAT agreement, the special rules of those articles will prevail upon the reverse charge mechanism if the client is not established in the country of the supply.

For example, for a service related to a real estate VAT is due where the building is located, for hospitality or recreational services, VAT is due where the service is used.

In UAE and KSA, under specific conditions, the reverse charge mechanism is applicable for import VAT.

For operations between implementing States each State, ask for a special wording in the invoice indicating that the VAT is due by the client and for the tax registration number of the supplier and the client. The invoice must be issued without VAT.

On an accounting point of view, at least two new accounts must be added in the chart of accounts, one for the input VAT and the other for the output VAT of the reverse charge mechanism. The accounting entry should move those two accounts for the same amount.

The client must report both purchase (input VAT) and supplier's sale (output VAT) in the VAT return for the same amount calculated on the price of the supply.

Both amounts offset each other and lead to zero and avoid any cash disbursement linked to those operations.

However, with special cells in the VAT return the Tax authorities have full visibility of the transactions at stake.

Even though there is no cash disbursement, in case of non-compliance there are some heavy drawbacks in each implementing State.

First, the article 44 of the GCC VAT Agreement prevent the deduction of the input VAT on reverse charge if the output VAT is not declared. Therefore, in case of tax audit output VAT will be reassessed without deduction of the input VAT. Furthermore, depending of the date of the tax audit, the input VAT could be definitively lost because of the prescription.

On top of that, in both countries, KSA and UAE there is a penalty of 50% of the missing VAT. In UAE, there is an additional fine of AED 3,000.

Therefore, the reverse charge mechanism must be properly implemented in the IT system and carefully monitored before each VAT return.

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