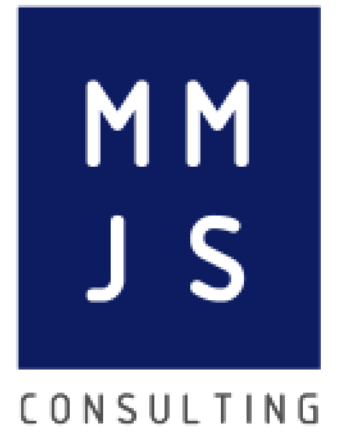


TAXABILITY OF EXPENSE RECOVERIES

CHALLENGES FACED BY UAE

BUSINESSES



Expense recharges are customary for VAT registered businesses. Expenses are incurred by businesses in the course of supplying goods or services to its customers to be subsequently recovered from them.

‘Recovery of expenses’ is a term that is not categorically defined under the VAT legislations. The taxability of expense recoveries or recharges is a topic that is constantly subject to interpretation across VAT jurisdictions.

Reimbursement Vs Disbursements

To determine the taxability, businesses need to identify expense recoveries as either ‘Reimbursements’ or ‘Disbursements’ for the purpose of VAT. A reimbursement falls within the scope of VAT, whilst a disbursement is outside the scope.

Whether an expense tantamount to a reimbursement or a disbursement depends on if it was incurred as a principal or an agent. The fundamental principle that is observed by VAT/GST jurisdictions around the world, is that if the business incurred the expense as a principal, recovery would amount to a reimbursement and on the contrary, if the expense was recovered by the business acting in the capacity of an agent, recovery will be a disbursement. Accordingly, the underlying agent-principal relationship must be examined by the businesses at the on-set.

Agent – Principal Relationship

An agent is a person who is employed by a principal supplier to act on his or her behalf. The rules surrounding the principal - agent relationship set out under Article 9 of the UAE VAT Decree Law is consistent with the principal followed globally. According to Article 9, a supply of goods and services is considered to be a supply by the principal where the agent is acting in the name of and on behalf of a principal. Whilst it provides that the supply of goods and services through an agent acting in his name is considered to be a direct supply by the agent and for his benefit.

Taxability of recovery of expenses

Characteristics to other VAT/GST jurisdictions, the UAE VAT legislation is silent on the VAT treatment of reimbursement and disbursement, however the Federal Tax Authority has released a public clarification VATP013 which prescribes the criteria that must be considered while determining whether a recovery of expense satisfies the conditions to be treated as a reimbursement or a disbursement.



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The conditions prescribed under VATP013 are enumerated below:

| S. No. | Conditions to be satisfied to be classified as a Disbursement | Conditions to be satisfied to be classified as a Reimbursement |
|--------|--|---|
| 1. | The other party should be the recipient of the goods or services; | You should have contracted for the supply of goods or services in your own name and capacity; |
| 2. | The other party should be responsible for making the payment to the supplier; | You should have received the goods or services from the supplier; |
| 3. | The other party should have received an invoice or tax invoice, as the case may be, in its own name from the supplier; | The supplier should have issued the invoice in your name and you are under the legal obligation to make payment for it; |
| 4. | The other party should have authorized you to make the payment on his behalf; | In case of goods, you should own the goods prior to making the onward supply to the other party. |
| 5. | The goods or services paid for should clearly be additional to the supplies you make to the other party; | |
| 6. | The payment should separately be shown on the invoice and you should recover the exact amount paid from the supplier, without a mark-up. | |

The challenge

The criteria cited under VATP013 are structured to subsume transactions under the scope of reimbursements and disbursements. However, there is no indication that all the criteria must be fulfilled before a recovery can be perceived as a reimbursement or disbursement. Since the clarification is elusive about the matter, businesses are cautious while identifying expenses as reimbursements or disbursements and in the absence of specific guidance indicating otherwise, it is recommended all the criteria must be fulfilled.

Whilst these criteria serve as useful indicators, the strict application of all the criteria may not be appropriate in all business scenarios and not consistent with the business practices in the region. In addition, there is a risk of distorting the underlying business function while trying to categorize a transaction into either a reimbursement or disbursement.

For instance, a transaction may be exempt, zero-rated or outside the scope of VAT however, the taxability of the subsequent recovery requires businesses to contemplate the principles of reimbursements and disbursement.

For instance, an analysis of each of the criterion listed under VATP013 with respect to disbursement suggests that certain expense recoveries fulfill all the conditions with the exception of one i.e. “The other party should have received an invoice or tax invoice, as the case may be, in its own name from the supplier”.

It is imperative to note the mere incidence of an invoice would not alter the legal and contractual obligation of the contracting parties and in many instances, goods or services are procured solely for the benefit of the customer and invoice is issued to a party out of commercial convenience. Although ensuring that the tax invoice is received in the name of the customer/principal is relevant from a VAT recovery perspective, placing high importance on receiving invoices in the name of the customer would be stringent.

However, as a consequence of failure to fulfill the above-mentioned criterion, the expense recovery cannot be subsumed under the scope of disbursement and businesses cautiously treat the same as a reimbursement.

Conclusion

Businesses in UAE are bemused by the practical implementation of the clarification and commercial sensitivities of their customer dealings. The subjective nature of the criteria discussed under the clarification is fueling the on-going debates surrounding expense recoveries.

Whilst the clarification provides solace to the businesses with regards to the taxability of expense recoveries, there are a lot of avenues for the businesses to consider. The commercial substance of a transaction must also be considered in conjunction with the contractual and legal obligations in determining whether an expense recovery tantamount to a reimbursement or disbursement.