

## THE REVERSE CHARGE MECHANISM APPLICATION

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## Subject matter of this Circular

- The Gulf Cooperation Council (GCC) Unified VAT Agreement requires that VAT is charged on receipt by a Taxable Customer of Goods or Services supplied to him by a Non-Resident and Non-Taxable Person in the Member State in instances where the Reverse Tax Mechanism applies<sup>1</sup>. Accordingly, the Implementing Regulations state that Tax is imposed on all Taxable Supplies of Goods and Services made in the Kingdom by a Taxable Person in the course of economic activities, or received in the Kingdom by a Taxable Person in instances where the Reverse Charge Mechanism applies, as well as on Imports of Goods<sup>2</sup>.
- This Circular considers the application of the Reverse Tax Mechanism rules to businesses receiving a supply of goods or services, which are supplied in the Kingdom under the place of supply rules from a non-resident supplier.

## 1. Reverse Charge Mechanism Application Cases

- Reverse Charge Mechanism is defined in the GCC Unified VAT Agreement as the mechanism by which the Taxable Customer is obligated to pay the Tax due on behalf of the Supplier, and is liable for all the obligations provided for in the Agreement and the Local Law<sup>3</sup>.
- Reverse Charge Supplies refer to Supplies on which the Customer is obliged to pay the VAT due under the Reverse Charge Mechanism.

<sup>1</sup>Article 2, Scope of Tax, Unified VAT Agreement

<sup>2</sup>Article 14, Taxable Supplies in the Kingdom, VAT Implementing Regulations

<sup>3</sup>Article 1, Definitions, Unified VAT Agreement

## 1.1. Scope of Reverse Charge Mechanism Application

- In general, the Reverse Charge Mechanism is only due on services received by the Taxable Customer from the Non-Resident in the territory of the GCC states supplier which are taxable in nature. Additionally the reverse charge mechanism apply when a taxable person receives goods or services, which are subject to tax, from a person resident in another member state<sup>4</sup>. Subject to the transitional provisions on considering importing goods and services from outside the kingdom as an import of goods and services for VAT purposes, until the implementation of the Electronic Services System in all Member States<sup>5</sup>.
- **Examples of services that fall within the scope of the Reverse Charge Mechanism application – a non-exhaustive list are:**
  - Legal and professional services.
  - Membership/ subscription services.
  - Advertising services.
- **Reverse Charge Mechanism is not applicable on the following:**
  - The receipt of exempt services (for example: financial services received from a non-resident supplier). Such supply is not a taxable supply;
  - Where a non-resident supplier makes a supply of goods or services subject to VAT in KSA to non-taxable persons. In this case, the Supply is subject to normal VAT liability rules. The non-resident supplier will be required to register for VAT in KSA and charge VAT on supplies<sup>6</sup>;
  - Services that are directly in connection with the five specific categories of services (Special Cases) outlined in the Unified VAT Agreement<sup>7</sup>. These are exceptions to the basic rule of Place of Supply and accordingly affect the tax due date.

<sup>4</sup>Article 9, Receiving goods & services, Unified VAT Agreement

<sup>5</sup>Article 79, Transitional provisions, VAT implementing Regulations

<sup>6</sup>Article 5, Mandatory registration of Non-Residents obligated to pay Tax in the Kingdom, VAT Implementing Regulations

<sup>7</sup>Articles (17-21), Unified VAT Agreement

**Example (1):** XY Co., a KSA company, sends employees to Jordan for business, where they stay and dine in a hotel in Amman. The services are supplied in Jordan, and are therefore not subject to the reverse charge mechanism on receipt by XY Co. as a taxable person in the KSA, which is not considered the place of supply<sup>8</sup>.

## 1.2. Import of Taxable Services by a VAT-Registered Person

- There is no formal import procedure for services, and VAT is not collected on an event of importation of services by Saudi Customs in the same way as for goods from outside the kingdom.
- VAT is charged on services which are supplied in the KSA to a Taxable Person by a non-resident supplier by way of the Reverse Charge Mechanism.
- A non-resident supplier is a Supplier with no place of business or other fixed establishment in the KSA: where an establishment is a primary place of business, or any other fixed location, with the permanent presence of human and technical resources in such a way as to enable the Person to supply or receive Goods or Services<sup>9</sup>.

<sup>8</sup>Article 21, Supply of other services, Unified VAT Agreement

<sup>9</sup>Article 1, Definitions, Unified VAT Agreement

**Example (2):** Nasser owns a VAT-registered electronics store in Riyadh. Nasser's store uses a software subscription from a Canadian-based firm. Since the software is delivered electronically, it never goes through the Customs procedures.

The Canadian firm is not registered in KSA for VAT purposes, so it is not obligated to file any VAT returns or pay KSA VAT. However, Nasser is a KSA registered taxpayer and has acquired services from a non-KSA-based software firm, so he must account for the VAT due via the reverse charge mechanism for the transaction on his relevant VAT return.

### 1.3. Receipt of services from a non-resident supplier

- As stated in the Implementing Regulations<sup>10</sup>, the Reverse Charge Mechanism applies in cases where a Taxable Person receives, from a non-resident supplier, a supply of services which are supplied in the KSA under applicable VAT place of
- supply rules. The receipt of services by a Taxable Person – when those services are supplied in the KSA (under the place of supply rules) – from a non-resident supplier are also subject to VAT under the Reverse Charge Mechanism at the applicable rate.
- “If a Taxable Person residing in a GCC Member State receives Services from a person who is not resident in the GCC Territory, then that Person shall be deemed to have supplied these Services to himself, and the Supply shall be taxable according to the Reverse Charge Mechanism”<sup>11</sup>.

<sup>10</sup>Article 47(1), Persons liable to pay Tax, VAT Implementing Regulations

<sup>11</sup>Article 9, Receiving Goods and Services, Unified VAT Agreement

- Under the Reverse Charge Mechanism, the recipient is deemed to have made the supply of services to himself. Therefore, the recipient must report Output VAT, and is at the same time eligible to deduct corresponding Input VAT, provided the standard criteria for deduction are met.

**Example (3):** ABC Consulting firm, a KSA resident and registered company, engaged with a Dutch legal advisor to provide legal advice for the possible expansion of ABC Consulting in Netherlands. The Dutch legal advisor issued an invoice for the fee of 10,000 USD (Approx. 37,000 SAR) in December 2020. No KSA VAT is charged on the invoice issued by the Dutch advisor and will therefore not be a Tax Invoice complying with the invoice requirements included in the KSA VAT legislation. The Saudi firm ABC is obligated to account for VAT on services received from the Dutch advisor as per the reverse charge mechanism with amount of 5,550 SAR.

As the invoice issued by the non-resident advisor shows the date of supply and consideration payable, it can be used to evidence the calculation of the taxable amount in order to determine the VAT due on the supply.

## 1.4. Other Consideration - Imports of Goods

- As a general rule, imported goods into KSA are liable to VAT at the point of entry. The VAT payable on the import of goods must be paid to Saudi Customs, together with the duty and other charges indicated on the Customs declaration, in order to facilitate the release of goods into free circulation. During the transitional period for GCC VAT, the receipt of Goods into the Kingdom from another GCC Member State by a Taxable Person will be treated as an import of goods to the KSA.



## 2. Tax Due Date under Reverse Charge Mechanism

- The tax due date refers to the date when the VAT on a supply is due and when a Taxable Person must either account for the VAT to ZATCA, or in the case of input tax when a Taxable Person is entitled to reclaim the input tax.
- The Unified VAT Agreement, VAT Law and Implementing Regulations set out the general rules in order to define the tax due date for supplies of goods and services, as well as the special rules applicable to certain types of transactions.
- The general rules to determine the tax due date are that Tax becomes due on the date of the supply of Goods or Services, the date of issuance of the tax invoice or upon partial or full receipt of the consideration, whichever comes first, and to the extent of the received amount<sup>12</sup>.
- These rules apply to most supplies of goods or services which are “one-off”, and not provided on a continuous basis, special rules are applicable on continuous supplies of services made over periods of longer than a year<sup>13</sup>.
- The date the supply takes place may be earlier than the actual date of supply, in cases where a tax invoice is issued or payment is received before the actual date of supply.
- The same rules will apply to the tax due date for supplies made under the Reverse Charge Mechanism.

<sup>12</sup>Article 23, Date of Tax Due on Supplies of Goods and Services, Unified VAT Agreement

<sup>13</sup>Article 20, Date of supply in specific circumstances, VAT Implementing Regulations



### 3. Reporting Tax Calculated under Reverse Charge Mechanism

- VAT must be reported by the supplier/recipient during the Tax Period in which that date of supply falls. Whilst each supply has a separate date of tax becoming due, the payment of VAT by the supplier/recipient to ZATCA is only required when the VAT return is filed (and the corresponding Net Tax for that entire tax period is due for payment). Likewise, the Input VAT is also claimed (where appropriate) in the Tax Period where the date of supply falls.
- Exceptions may exist in the case of the cash accounting system.
- Each VAT registered person, or the person authorized to act on their behalf, must file a VAT return with ZATCA for each monthly or quarterly tax period. The VAT return is considered the taxable person's self-assessment of tax due for that period.
- The VAT return must be filed, and the corresponding payment of net tax due made, no later than the last day of the month following the end of the tax period to which the VAT return relates.
- Fields 1 through 6 of the VAT return relate to VAT on sales; fields 7 through 12 to VAT on purchases. Fields 13 through 16 relate to determining the amount of Net VAT due as a result of the relevant transactions for the period of the VAT return.
- The VAT accounted for under the Reverse Charge Mechanism must be entered in field 9 of the VAT return form. The VAT return form automatically assumes input VAT is fully deductible by the recipient on the supplies received, the reporting of the same amount of output tax and input tax takes place in field 9 of the same VAT return, by entering the value of the goods and services received in the first column.

**Example (4):** a UAE security services company established in the UAE also has a registered branch of the same entity in Riyadh, which provides online security for companies. The Company enters into a contract to provide remote monitoring services for a storing company in Riyadh. The storing company enters into a contract directly with the Security Company representatives in the UAE, and all services are provided from personnel and equipment in the UAE. In this case, whilst the Security Company has a KSA branch, the UAE head office is most closely connected to the supply of the services. Therefore, the Security Company is considered a non-resident in respect of this supply<sup>14</sup>.

As a result, the KSA storing company must report the value of the contract as supplies received from a non-resident and VAT is to be accounted under the reverse charge mechanism.

Taxable Persons who are not fully entitled to deduct VAT in relation to that supply must make a corresponding adjustment to field 9 of the VAT return.

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<sup>14</sup>Article 1, Definitions, Unified VAT agreement.

**Example (5):** a bank established in KSA and registered for VAT purpose makes both taxable and exempt supplies; and it is able to deduct 70% of the VAT it incurs on non-attributable costs under its proportional deduction calculation. The Bank receives legal advice in respect of their entire operations from a specialist UK law firm. The law firm charges the equivalent of SAR 100,000 (based on the Saudi Central Bank prescribed daily exchange rates) on its invoice for the report, dated 21 December 2020.

In the VAT return for the month of December, The Bank enters the amount of SAR 100,000 into field 9, to reflect the supply subject to the reverse charge mechanism. In order to account for the 30% of non-deductible input VAT, The Bank enters SAR 30,000 in the adjustment field of field 9. The VAT return calculates VAT payable of SAR 4,500 in respect of the receipt of services.

Field	Amount (SAR)	Adjustment (SAR)	VAT Amount (SAR)
9 - Imports subject to VAT accounted for through reverse charge mechanism	<b>100,000</b>	<b>30,000</b>	<b>4,500</b>

- The entry in field 9 of the VAT return – without adjustment – results in VAT payable being fully offset by the Deductible Tax on the supply. Any imports of goods that have been declared to Saudi Customs during the Tax Period must be disregarded. Import VAT is reported separately in field 8.

## 4. Input Tax Deduction

- The standard timing for a Taxable Person (who uses the standard invoice accounting basis to report VAT) to exercise the right to Input Tax deduction, is the tax period in which the supply takes place. This is usually the date the goods or services are received, and the Tax Invoice or relevant documentation is issued to the Taxable Person.
- Deduction cannot be exercised until the Taxable Person, who is the Customer in respect of the supply, has a valid Tax Invoice (or commercial documents in case of non-resident suppliers) for the supply. It is not required that any specific onwards supply has been made (of the goods or services purchased) to be able to deduct the Input Tax on the purchase of those goods or services.
- In addition to VAT charged by VAT registered suppliers in the KSA, the self-accounted VAT under the Reverse Charge Mechanism on a supply of goods or services in the KSA is eligible for deduction.
- “A Customer who is obligated to pay Tax pursuant to the Reverse Charge Mechanism may deduct Deductible Tax related thereto provided that he has declared the Tax due under Article 41 (2) of this Agreement”<sup>15</sup>.
- VAT deduction is available for the VAT due and reported by a taxable person under the Reverse Charge Mechanism, provided that the goods or services received are for the purpose of the taxable person’s economic activities in the course of making taxable supplies. The reporting of the reverse charged VAT is a condition for the corresponding deduction.

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<sup>15</sup>Article 44(3), Tax Deduction Principle, Unified VAT Agreement

- VAT is treated as Input Tax only for the Customer who has self-accounted for VAT under the Reverse Charge Mechanism. For Customers who are fully taxable, or who have acquired the goods or services for a taxable use, a full deduction of the VAT under the Reverse Charge Mechanism does not result in any payment of tax in the return.
- Whilst the Reverse Charge Mechanism involves a deemed supply of services by the recipient, the recipient is not required to issue a tax invoice to itself in respect of this supply. The recipient should however retain the supplier invoice with its business records to support the calculation of VAT under the reverse charge mechanism.
- In order to be eligible for the deduction of Input Tax on such a supply, the KSA Customer should have commercial documents available to evidence the nature of the supply and the consideration payable on the supply, in addition to the corresponding calculation of tax due on the supply.

## 5. Failing to report tax due under Reverse Charge Mechanism & the Right to Deduct

- The Implementing Regulations state that a Taxable Customer is obligated to pay Tax on a supply received from a non-resident supplier, and that the Tax shall be paid by way of the Reverse Charge Mechanism<sup>16</sup>. Therefore, the obligation is on the Taxable Customer to pay the (output) Tax in the correct period, and failing to do so could lead to penalties.
- The right to deduct Input Tax for the Customer of a supply is linked to the obligation of the supplier to pay the tax due on the supply – i.e. the date of supply. However, in the case of the Reverse Charge Mechanism application, the input tax deduction will be linked to the obligation of the taxable customer to account and report for VAT under the reverse charge mechanism.
- Furthermore, the Regulations allow a Taxable Person to deduct Input Tax in a tax period subsequent to that tax period including the date of supply, subject to a statutory limitation of five years following the year in which the supply takes place<sup>17</sup>.
- A deduction of Input Tax may be made by a Taxable Person in a Tax Period subsequent to that Tax Period including the date of Supply, provided that the Taxable Person remains eligible to make such deduction under the other provisions of the Law and Regulations. Input Tax may not be deducted in any period which falls more than five calendar years after the calendar year in which the Supply takes place.

<sup>16</sup>Article 47(1), Persons liable to pay Tax, VAT Implementing Regulations

<sup>17</sup>Article 49(8), Input Tax Deduction, VAT Implementing Regulations

# هيئة الزكاة والضريبة والجمارك Zakat, Tax and Customs Authority



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