Uganda's reverse charge VAT obligations

Closing tax exposure gaps

It is now more than 20 years since Value Added Tax (VAT) was introduced in Uganda in 1996 replacing Sales Tax and Commercial Transactions Levy (CTL). These taxes used to be levied on the sale of goods and services respectively.

VAT on the other hand applies to both goods and services and is conceptually superior compared to sales tax. It is however interesting that the business community was apprehensive at the beginning, strongly objected to its introduction and even staged a countrywide strike protesting its implementation in October 1996.

Origin of VAT

The idea of VAT traces back to the 1920 writings of German businessman Wilhelm Von Siemens. It was however not until 1954 that France took the bold step to introduce it followed by other European countries. The adoption of VAT was a key feature of the tax reforms undertaken by many developing countries in the 1990's. Many countries now have VAT as part of their tax system.

VAT addresses the cascading impact that sales tax has where tax is imposed on tax. Sales tax is collected at every stage in the production-distribution supply value chain. The tax base at any single stage is the sum of the sales value of the goods plus the tax charged cumulatively in previous stages along the production-distribution supply value chain. Tax on tax escalates the prices of goods and services.

Businesses are however able to claim the input VAT that they incur on their purchases for business operations. This ensures that the final consumer to whom a sale is made pays VAT only on the value added by the business which is not the case with sales tax thereby eliminating the cascading impact of tax.

Output and input VAT are commonly used terms in the Value Added Tax system. The tax charged by the seller of goods and services is known as output VAT while the VAT incurred on the purchase of goods and services is known as input VAT. Taxpayers only have to remit VAT to tax authorities if their output VAT exceeds their input VAT in which case they pay the difference. Taxpayers are entitled to a refund of VAT if their input VAT exceeds their output VAT.

Acceptance of VAT

With continued engagement and sensitization, VAT was accepted by the Ugandan business community and there is now a fair amount of knowledge on how it operates. This notwithstanding, there are two concepts that still confuse taxpayers and it is our observation in the course of our practice that they are the major drivers of VAT liability in the tax audits conducted by the Uganda Revenue Authority (URA).

These concepts are that of *reverse charge VAT* and *application to own use*. In this article, we discuss the concept of reverse charge VAT. Application to own use will be addressed in our next publication.

What is reverse charge VAT?

Reverse charge VAT departs from the normal principles of VAT. The normal principles of VAT are that the seller of goods and services charges, collects and remits the VAT to the URA. Under the reverse charge mechanism, the rules are however flipped. The recipient/buyer rather than the seller of services as is the norm self-charges output VAT on the imported services received and where applicable remit the VAT to the URA.

Reverse charge VAT in Uganda is provided for under Section 4(c) of the Value Added Tax Act (VATA) which imposes VAT on non-exempt services imported by any person. The standard VAT rate is 18% but some supplies are zero rated or exempted from VAT as the law prescribes. The other instances other than the reverse charge mechanism where VAT is charged are on the sale of goods and services by VAT registered persons and the importation of non-exempt goods by any person.

VAT at importation of goods is paid when the consignment is cleared for customs duty purposes. The normal principles of accounting for VAT apply on sales of goods and services by VAT registered persons. The seller must complete a VAT return by the 15th day of the month following supply and make payment of the VAT charged from its customers to the URA unless there is input VAT to credit against the output VAT.

The reverse charge mechanism as explained subsequently applies to the importation of services.

Rationale behind reverse charge VAT

Reverse charge VAT is originally a European Union (EU) concept. Before its introduction, there used to be VAT fraud which was being perpetrated through the use of service invoices purportedly from vendors in other EU member countries and some vendors would be encouraged to use these invoices to lodge fictitious VAT refund claims. The reverse charge mechanism therefore eliminates VAT refunds given that there is no cash outflow under normal circumstances on the declaration of imported services by a business.

Unless the recipient of the imported services is a final consumer or is a business with mixed supplies (exempt and VATable supplies), the common practice is that reverse charge VAT is tax neutral. This ideally means that there is no cash outflow by the business on declaration of the imported services.

Though never a consideration in inventing the reverse charge VAT concept, we have noted in the course of our practice that a proper audit of reverse charge obligations by tax authorities can expose areas of non-compliance with regard to withholding tax (WHT) if any. Taxpayers should under normal circumstances be able to reconcile the WHT paid on qualifying payments to non-resident persons with the reverse charge VAT declared. Non reconcilable variances are pointers of under declaration of either WHT or reverse charge VAT.

Accounting for reverse charge VAT in Uganda

Until 2012 when the VATA was amended, reverse charge VAT in Uganda was tax neutral. Taxpayers that imported services into Uganda for their business operations would self-charge VAT at the rate of 18% on the value of the services received. They would include the arising output VAT on the imported services in their VAT return but also claim a corresponding credit as input VAT. There would be no cash outflow as the input credit would net off the output VAT declared. This was however not the case with final consumers of services, non-registered persons or taxpayers that made both exempt and VATable sales. They would have some payment to make to the URA.

With the amendment of the law in 2012, the taxpayers' ability to claim as an input credit the output VAT declared on imported services was removed. This new position departed materially from the norm as explained above under most global VAT systems. It is only Uganda and Rwanda that take this position in East Africa. The 2012 amendment was criticized by the business community and tax experts alike who decried its impact of increasing the cost of doing business in Uganda. Some services cannot be sourced locally. Denying taxpayers a VAT credit for

essential services procured to run their business operations crystallizes an unnecessary expense.

Taxpayers must declare this VAT in accordance with the reverse charge mechanism. VAT registered persons therefore incorporate their imported services as a supply they have made and account for output VAT on the same in the VAT return that they submit to the URA on the 15th day of the month following when the supply was made. A supply for VAT purposes is made at the earliest of an issued invoice, the payment for the supply or the actual performance/receipt of the service. Non VAT registered persons generate a payment slip that they use as the basis of paying to URA the reverse charge VAT on the imported services.

Reforms in the reverse charge VAT system

The reverse charge VAT mechanism originated from the EU principally to counter cross border VAT fraud. It was never intended to be a means of collecting taxes from intermediate businesses that procured these services for their operations.

The Government of Uganda contended that its main policy driver behind the 2012 amendment was its objective to incentivize the purchase of local services over foreign services which would be more expensive as a result of the VAT charged. While this is a legitimate concern, it is also noteworthy that some specialized services cannot be sourced locally. The government ought to have created a window of exception for some of these specialized services.

Cognizant of the adverse economic impact reverse charge VAT had on the viability of capital projects and the impending commercialization of Uganda's oil and gas discoveries, the law was amended in 2015. Services imported for petroleum activities, mining operations and donor funded projects would no longer have to pay the reverse charge VAT at declaration because under the law, the output VAT chargeable is deemed paid.

The law was further amended in 2016 allowing process outsourcing companies to claim as an input credit the output VAT that they account on their imported services. The government indicated it was their desire to create a regional hub to outsource enterprise solutions remotely to regional companies while in Uganda. Though this is laudable, there are other considerations to take into account to create a most competitive environment for this kind of investment including further bringing down the cost of electricity, internet and credit.

Though the VATA has been amended since 2015 to modify the reverse charge VAT mechanism, there is still a good case that Uganda should revert back to the pre-2012 position if it is to lower further the costs of doing business. Imposing reverse charge VAT on business operations places a cash flow strain sometimes compelling enterprises to borrow to finance the tax charge.

It should also be recalled that the VAT paid on importation of services becomes a part of the business operational costs and the same are deductible in the determination of the corporation tax payable. While government collects VAT on the imported services in the short run, it receives lesser corporation income tax at the end of the year because of the escalated operational costs partly arising from this VAT charge. The cash flow strains imposed as a result of the VAT charge can also stifle business growth and optimal production by many enterprises. ■

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