

FREE RELATED PARTY DEALS TRIGGER VAT: By Jonathan Hore

It often happens that companies and or other persons who are related offer services or goods to each other for free. The question which arises is whether VAT must be accounted for on such free related transactions. I will explore the said matters in detail below. In this article, words importing the masculine shall be deemed to include the feminine.

What are related parties

As enunciated above, the VAT Act requires that transactions between related parties be subject to VAT but we need to establish who qualifies as related parties. In most instances, it is a shareholder and a company he owns or a holding company and its subsidiaries. A partner and the partnership he is a partner to also makes the two parties related, for VAT. By nature, transactions between related parties are most likely to be for free or at some conditions which are not arms' length, making the legislature jittery as VAT may be lost.

As the supply of goods or services between related persons is usually conducted for free or at abnormal discounts, that in itself creates a hole in the VAT collection system. For example, if company A uses office space in a property owned by company B, the free usage is a transaction which could otherwise be subject to VAT had the two companies not been related. The fact that they are related results in market principles being compromised and VAT gets lost in the process.

Moreover, in a case where company C is to provide any services to company B, VAT will be triggered the moment those services are performed for company B. It is important to note that the relationship between the companies allow for VAT to be charged without the issuance of an invoice or receipt of payment.

If a company which is registered for VAT offers free commercial space to a related party as stated above, VAT must be accounted for on the market value of such office space. Further, if another VAT registered company transfers a farm to its shareholder for free, VAT is still required to be paid on such farm regardless of the fact that it may not have actually been charged. Further, the owner of a car dealership who takes one of the cars for his usage must be aware that his business will have to pay VAT on the car he takes for personal use.

Intention of the law

As explained above, payments or invoices are not the triggers for VAT in this instance, which means that when company A offers any managements services to company C, the value of the services should be charged VAT at the standard rate of 14%. Normally transactions that trigger VAT should be associated with a certain payment or tax invoice for the services or goods but since related persons can offer each other services for free, VAT should be accounted for even without tax invoices.

The intention of the law is to ensure that the fiscus does not lose out on VAT because of a relationship between two entities. As an example, if company A and company C where not related persons, the recipient of the goods or services will be charged VAT on the value of the services or goods provided. This explains why the dealings between the two companies are deemed to be VAT-inclusive.

Accounting for the VAT

The VAT arising from related party transactions should be accounted for through the companies' VAT returns at the time of submission of the returns. The VAT will be triggered

and accounted for despite the fact that an invoice may not have been issued and whether or not a payment is made.