

Verification of Merchant of Record status

The facts

A company established and residing in the UAE (UAE Co.) is going to distribute applications it has developed. It is considering using the payment process of an intermediary (a “Merchant” or “Agent”) who declares that he is a merchant of record and takes the responsibility for VAT compliance in all markets where the subscriptions are sold.

The report from the Merchant will show which of the customers purchasing the subscriptions are located in the UAE. The Merchant is a non-resident in the UAE but has a VAT registration in the UAE.¹

The question

Will such engagement of the Merchant excuse UAE Co. from VAT obligations in the UAE?

The table of contents

| | |
|---|----|
| The summary | 2 |
| <i>The analysis</i> | 3 |
| <i>Place of supply</i> | 3 |
| <i>Rules for sales via agents</i> | 4 |
| <i>How to identify the status of an agent: an example of analysis</i> | 6 |
| Self-declared as Merchant of Record, Reseller and Not an Agent..... | 6 |
| Analyze the entire arrangements | 7 |
| What does the end-user see? | 8 |
| What might the FTA say? | 9 |
| Alternative option | 11 |
| One more alternative | 11 |
| On balance..... | 12 |
| The disclaimer | 12 |

¹ The merchant, contractual arrangements, and any provisions mentioned in this article are used solely for illustrative purposes. They do not refer to any specific merchant or business entity. Any resemblance to actual individuals, companies, or contractual arrangements is purely coincidental.

The summary

After considering the facts and the analysis below, we opine as follows:

- 1) UAE Co. must charge VAT on sales to users from the UAE.
- 2) The Merchant of Record model implies that an intermediary makes end-users sales under its name rather than under the name of the principal. Where this model is **actually** implemented:
 - a) The principal charges UAE VAT to the agent (merchant of record) as though it sold subscriptions to the agent.
 - b) The agent charges VAT to end-users as though he is a reseller.
 - c) The agent credits the input VAT that the principal has charged him.
 - d) The Agent charges VAT on his commission if it is not embedded as a mark-up, and the principal applies an input VAT credit for this VAT.
- 3) An agent in a Direct Sale model allows developers and creators to sell digital products (including software and apps) directly to customers, while the agent facilitates the transactions. In this model, the agent can sell in the name of the principal rather than in his own name. If this is the case:
 - a) The principal charges UAE VAT to the users.
 - b) The agent charges VAT on its commission.
 - c) The principal credits the input VAT that the agent has charged him.
- 4) In a direct sale model, the agent can replace the principal in the obligation of issuing a tax invoice to the end-users. Such invoice 'may include the agent's, rather than the supplier's, details – in which case, the invoice should, however, contain a reference to the principal supplier (including the supplier's name and TRN) somewhere on the invoice'. Furthermore, the supply is still treated as being made by the principal, i.e. the principal must account for the relevant VAT.²

The example in the analysis illustrates that intermediaries can overdo things in their efforts to substantiate their Merchant of Record status. In the contracts, rules of services, and other paperwork, they include a clause which prohibits them from being treated as agents acting on behalf of the vendors. This constrains the above opportunity to authorize the agent for the tax invoicing. Furthermore, a comprehensive analysis may show that a key attribute of this model is missing if the vendor is disclosed in the contract with the user and/or the user enters into a direct contract with the vendor.
- 5) The specific contractual and actual arrangements have to be addressed to identify which model they create. The declaration of the agent that he applies one model or another would be dismissed by the FTA if they don't correspond to the contractual terms and actual relationships.

² FTA's E-commerce VAT Guide No. VATGEC1, Sec. 5.4.

- 6) If an agent or principal has incorrectly classified the model they actually use, this makes no difference for the state budget but can nevertheless trigger a VAT assessment.
- 7) The inconsistency in contractual terms and other relevant paperwork creates a number of options (approaches) that the FTA may take. Since it is uncertain which approach will actually be taken, this entails uncertainty. The company will not be safe as any approach it chooses could potentially diverge from what the FTA will think. To obtain certainty the UAE Co. may seek a private clarification from the FTA.

The analysis

We have so concluded further to the considerations described below.

Place of supply

1. Under Article 32(2) of the [VAT Executive Regulation](#) '*electronic services mean services which are automatically delivered over the internet, an electronic network, or an electronic marketplace, including:... supply and updating of software*'.
2. In the case at hand, UAE Co. will supply the software via its website, with the software being automatically delivered to the customer over the internet. Thus, the supply of software should be considered a supply of electronic services.
3. The place of supply for electronic services is:
 - a. '*In the State [UAE], to the extent of the use and enjoyment of the supply in the State [UAE].*
 - b. '*Outside the State [UAE], to the extent of the use and enjoyment of the supply outside the State [UAE].*

The actual use and enjoyment of all telecommunications and electronic Services shall be where these Services were used regardless of the place of contract or payment'.³

4. Therefore, if the use and enjoyment of the software takes place in the UAE, the place of supply is the UAE and the supply of the software by UAE Co. should be subject to 5% VAT in the UAE.

If the use and enjoyment of the software take place outside the UAE, the place of supply is outside the UAE and the supply is not within the scope of UAE VAT.

5. The place of use and enjoyment is determined as follows⁴:

'In the case of an electronic service which is delivered to a physical place, the place of use and enjoyment of that service is that physical place. For example, where electronic services content can be only accessed from a

³ Article 31 of the [UAE VAT Law](#).

⁴ The VAT Guide on E-Commerce No. [VATGEC1](#), Sec. 4.2.

particular physical location, that location will be the place of use and enjoyment.

In the case of electronic services provided on a portable device, the use and enjoyment may be determined on the basis of the recipient's location at the time the services are supplied. For example, where music is electronically delivered to a recipient located in the UAE, the place of use and enjoyment will be the UAE.

For the purpose of determining the location of the recipient, some of the factors which may be indicative of the recipient's location are:

- the internet protocol ("IP") address of the device used by the recipient to receive the electronic service;*
- and / or*
- the bank details used by the recipient for the payment'.*

6. In the case at hand, the software is downloaded onto a computer or smartphone. Both can be considered a portable device. Therefore, the question of whether the use and enjoyment of the software occurs in the UAE may depend on the IP address of the recipient and the bank details used by the recipient for the payment.

We examined the process of a sale by visiting the websites of companies (vendors) that engage in similar arrangement with the Merchant. If a customer visits a vendor's website and attempts to purchase a product, on the payment page he can choose a country/region. If the UAE is chosen, the payment window automatically indicates that the purchase is subject to 5% VAT and the price includes this VAT. If he changes the country, the payment window would be automatically updated (for example, if Kuwait is inserted, no VAT is charged since there is no VAT yet in Kuwait).

Therefore, if a customer chooses the UAE as the country/region, the supply of the software is subject to 5% VAT in the UAE.

Rules for sales via agents

7. UAE Co. uses the Merchant as the payment process intermediary.

The VAT treatment of supplies using intermediaries will depend on the arrangement between the supplier, the intermediary (Merchant) and the recipient of the supply:

'Where the intermediary is acting as a disclosed agent between the supplier [UAE Co] and the recipient of the supply, then the supply is treated as made directly by the supplier [UAE Co] to the recipient.

Where the intermediary is acting as an undisclosed agent.... between the supplier and the recipient of the supply, then there are two supplies for

VAT purposes – from the supplier [UAE Co] to the intermediary, and from the intermediary to the recipient'.⁵

8. A disclosed agent is '*an agent which acts **on behalf and in the name of a principal**. In disclosed agency situations, **the recipient of the supply knows that it is dealing with an agent of a principal**, even if the recipient may not have any direct communication with the principal*'.

In accordance with Article 9(1) of the [VAT Law](#), a supply of services through a disclosed agent, is considered to be a supply by the principal (UAE Co.) and for its benefit. Thus, the VAT obligations for the supply will remain with the supplier, and the supplier should account for this VAT in its tax return if required under the normal VAT rules.

Consequently, if a customer is from the UAE, UAE Co. should account for 5% VAT if UAE Co. exceeds the mandatory VAT registration threshold of AED 375,000 for the previous 12 months.

9. An undisclosed agent is '***an agent acting in its own name, where the customer has no knowledge, and cannot be reasonably expected to have knowledge, that the agent is acting on behalf of a principal***. It should be noted that this situation is different from situations where no other principal is involved at all and the "intermediary" is a principal itself – in undisclosed agency situation, the agent is still acting on behalf of a principal'.⁶

Public Clarification [VATP033](#) issued by the FTA on 23 February 2023 gives a similar definition: '*If the e-Commerce Medium does not disclose the name of the supplier of the relevant goods or services, it shall be regarded as an undisclosed agent*'. In such cases:

- 1) '*the supplier shall be regarded as supplying the goods or services to the e-Commerce Medium, and the e-Commerce Medium shall be regarded as supplying the same goods or services to the customer*'.
- 2) '*The supplier is required to consider the supply to the e-Commerce Medium and whether it has UAE VAT implications*'.

In this case, there are two simultaneous supplies of services for VAT purposes – a supply from the supplier (UAE Co.) to the undisclosed agent (Merchant), and a supply from the undisclosed agent (Merchant) to the recipient of the supply.⁷

10. Generally, in terms of the agent's commission for its agency services, these agency services should be treated as a separate supply of services from the supply of the underlying goods or services. Nevertheless, '*where the [undisclosed] agent is able to embed the fee as a mark-up to the sale price of the goods or services, then the VAT treatment of the agency*

⁵ Ibid, Sec. 5.1.

⁶ Ibid, Sec. 5.3.2.

⁷ Ibid.

services should follow the VAT treatment of the underlying goods or services'.⁸

Therefore, arrangements with an undisclosed agent could be structured in two alternative ways:

- 1) The principal (UAE Co.) charges VAT on the price of the supply to the end-users via the agent. In this scenario, the agent applies an Input VAT credit for this invoice, and issues a tax invoice for his commission in the same manner as an undisclosed agent. The principal applies an Input VAT credit for the VAT charged by the agent on its commission.
- 2) The principal issues a Tax Invoice for the amount which must be paid to him after the commission cut. If this is the case, the agent doesn't issue a tax invoice for his commission.

The possibility for an undisclosed agent to credit Input VAT from the tax invoice of the Principal is recognized by the FTA in Sec. 5.3.2 of the Guide No. [VATGEC1](#).

How to identify the status of an agent: an example of analysis

11. The question of whether the Merchant acts as a disclosed or undisclosed agent should be established based on the contractual arrangement between UAE Co. and the Merchant, and the license agreements with end-users.

The latter was found on the website of vendors that engage in similar operations to Merchant. The Merchant is not mentioned in this agreement either as a Party or in any other capacity.

Self-declared as Merchant of Record, Reseller and Not an Agent

12. The template of the order form shows that UAE Co. will acquire digital retailer services from the Merchant. From Rules of Service for Vendors it follows that:

- ***The Merchant shall act as a reseller of the Products, purchasing Products from the Vendor and reselling them to Purchasers. This structure, where the Merchant is the seller and merchant of record of the Product, allows the Merchant to assume responsibility for all VAT, reporting and remittance for the Products sold via the Merchant's Service.***
- ***Vendor grants the Merchant a non-exclusive, non-transferable right and license to sell Vendor's Products to Purchasers via the Merchant's Service in order to provide the Merchant Service to Purchaser.***
- ***Vendor grants the Merchant a non-exclusive, non-transferable (except as otherwise provided) right and license to copy, distribute, provide access to and to deliver Vendor's Products to Purchasers via***

⁸ Ibid.

*the Merchant Service in order to provide the Merchant Service if and only if the Vendor has activated the fulfillment functionality within the Merchant App and the Order Forms are for Purchasers that the Vendor has directly referred to Merchant. **In such instances where the Vendor has referred a Purchaser to the Merchant, the Vendor grants the Merchant the right and license to copy, distribute, provide access to and to deliver Vendor's Products only to such referred Purchaser.***

- ***Legal ownership of the license rights for the Product(s) shall be transferred (a) from Vendor to the Merchant and (b) from Merchant to Purchaser only upon Purchaser's execution of the purchase agreement setting forth Merchant's terms and conditions of sale.***

This could lead to a conclusion that UAE Co. will sell the license to the Merchant and the latter on its own behalf and independently grants a sublicense to the end-user. This constitutes the typical model of the Undisclosed Agent.

Analyze the entire arrangements

13. However, this is actually not the case if read with other provisions of the Rules of Services. They set out that:

- *The Merchant's online payment system allows Purchasers to purchase Vendor's Products or a license right to Vendor's Products...*
- *The Merchant **shall not retain ownership of the license rights.** The Merchant's customer support is limited to assistance with the use of the Merchant Service, including web sites, shopping carts and order pages, and providing access to, and/or the delivery of, Products when applicable. Merchant shall have neither the right nor the obligation to provide warranty, maintenance or other support services for the Products to Purchasers.*
- *All requests for such warranty, maintenance or support services shall be forwarded in a timely manner to Vendor.*
- *End-User Agreements. Regarding Vendor's Products, **all end-user license agreements, in any form, are agreements solely between Vendor and the Purchaser. Merchant is not a party to such agreements.***
- *Agency. As an **independent reseller** of Vendor's Products, the **Merchant serves solely in the capacity of an independent contractor and at no time serves as an agent or employee of Vendor.** Nothing in this Agreement constitutes or shall be deemed to constitute a partnership or joint venture between the Parties, or to **constitute either Party as an agent of the other.***

The provisions on the [simultaneous transfer](#) of the license rights from the Vendor to the Merchant and from the Merchant to the Purchaser contradict the provisions on a direct license agreement between the Purchaser (end-user) and the Vendor. Indeed, if '*Legal ownership of the license rights for the Product ... [is] transferred (a) from Vendor to Merchant*' then at stage (b) '*legal ownership shall be transferred from Merchant to Purchaser*', since the Vendor has forfeited that right at stage (b). Thus, the Vendor shall not be a party to the license agreement with the Purchaser. However, the above provisions provide for the opposite scenario where the License Right is transferred directly to the Purchaser from the Vendor.

Furthermore, the License Right which the Vendor assigns to the Merchant is defined in the Rules as '*the right **on the part of the Purchaser** to install and use a Product*'. Thus, the Merchant may not be the License Right holder by definition. It doesn't actually obtain the license which it resells to the Purchaser. Rather, the Merchant is an assistant in a transaction concluded directly between the licensor (vendor) and licensee (Purchaser - end user). It may be said with some reservation that the Merchant obtains the right to distribute the product to a particular customer (the Purchaser) referred by the Vendor via the latter's website.

What does the end-user see?

14. We tried to buy a software subscription from the vendors that engaged in similar arrangements with the same Merchant. We found that:

- 1) To buy a subscription the end-user should visit a vendor's web site rather than the Merchant's.
- 2) There is a link to the end-user license in the description of the subscription. As said above, upon clicking the link, the user finds a direct end-user agreement with the Vendor, rather than the Merchant.
- 3) To buy the chosen product, the customer shall click the link in the description of the cost of the subscription. This link brings him to the next page within the vendor's website. Here, the end-user finds the vendor's logo in a central position and a pale logo of the Merchant under the text '*Sold and fulfilled by [Merchant's logo]*'. This text is given for the option Region UAE/Language English.

If the end-user switches language to another for the same region (UAE), the text would give different information which after translation reads "Orders are paid using the [Merchant] authorized **payment system** for this store".

15. This page contains a link to the Rules of Sale. These Rules are on the Merchant's site. At the beginning, the Merchant positions itself as a reseller: *these terms of sale ... constitute a binding legal contract **between ... Merchant... and the Purchaser**... These terms apply to all offers, sales and purchases of products (including, without limitation, ... software, license rights, and service use rights) or access rights to services*

Merchant provides (including, without limitation, extended download service or registration backup service) **obtained by Merchant from ...vendors... for purpose of resale by Merchant to you** ... either (a) through the online store on which Merchant has posted these terms, or (b) through any other means through which Merchant engages in the sale of products, such as but not limited to orders by phone.

However, another provision of these Rules specifies: **Where any Product supplied is or includes software, this Software is licensed to you (and not sold to you) by the licensor/owner subject to their license agreement or terms included with such Software or presented during your checkout process or software installation process.**

What might the FTA say?

16. In our view, the FTA is likely to find this construction far-fetched and artificially designed to give the Merchant the status of a reseller in a situation where it actually is a service provider and/or disclosed agent in a direct transaction between the end-user and UAE Co. (vendor). We address this issue below.
17. It is clear that the Merchant positions itself as a Merchant of Record, i.e. *the seller and merchant of record of the Product* and asserts that this *allows Merchant to assume responsibility for all VAT*. However, in our opinion, the actual contractual arrangement and facts show that the FTA may disagree and disregard this status. The FTA may use the above facts and provisions to claim that the Merchant is neither an undisclosed agent nor the reseller of the software.
18. In Sec. 5.2 of the [E-Commerce Guide](#), the FTA elucidates on how it will distinguish a disclosed agent, a reseller and an undisclosed agent:
 - 1) *'In order to determine the existence and the disclosed / undisclosed nature of an agency relationship, the starting point is to analyse contractual arrangements between parties'*. The above contractual arrangements leave no doubts that the end-user license agreement is concluded between the Vendor (UAE Co.) and End-User (Purchaser) directly. This doesn't match the definition of an Undisclosed Agent who *'is an agent acting in its own name, where the customer has no knowledge, and cannot be reasonably expected to have knowledge, that the agent is acting on behalf of a principal'*.
 - 2) *'The contractual arrangement should typically be taken as representative of the true relationship between parties unless it is clearly a sham or is fundamentally inconsistent with the reality of the actual transaction'*. We found no facts to infer that the direct contractual arrangement does not correspond the facts. However, in our view, the above facts may allow the FTA to disregard the claim of the intermediary that it is a reseller of product.

- 3) *'In interpreting contractual arrangements, it is only necessary to consider information which has been made available to the parties at the time they entered the agreement'*. Information referred to in the above is available to the end-user in the course of the sale. It gives enough data to him/her to establish that he/she is entering into a direct agreement with a vendor to receive the consideration (the software) for which it pays the Merchant.
- 4) *'...It should be noted that in some situations, a person may be described as an "agent", but will in practice make supplies of goods or services on its own account. For VAT purposes, such labels should be ignored and the person should be treated as a principal in respect of the relevant supplies'*. The situation at hand differs in terms of whom a person (Merchant) describes itself to: not an agent or an assistant but the (re)seller. However, the FTA is clear on how it will deal with situations where the self-description is inconsistent with actual practice. Hence, we find it likely that the FTA will disregard the 'Merchant of Record' (reseller) status of the Merchant and will treat the latter as a service provider and/or a disclosed agent.

This would make UAE Co. the principal of the supply where UAE Co. provides the license to the end-user.

19. Such treatment gives rise to the same consequences as if the software is supplied to the customer directly or via a disclosed agent: *'the supply of these goods or services is treated as made directly by the principal supplier to the recipient of the supply. As a result, the VAT obligations for the supply will remain with the principal supplier, and the principal supplier should account for this VAT in its tax return if required under the normal VAT rules'*.⁹

This implies that:

- 1) 5% VAT shall be charged by UAE Co. to the UAE end-users if UAE Co. exceeds the mandatory VAT registration threshold of AED 375,000 for the previous 12 months.¹⁰

Art. 59(11) of the [VAT Executive Regulation](#) provides for an exception: *'Where an agent who is a Registrant makes a supply of Goods and Services for and on behalf of the principal of that agent, that agent may issue a Tax Invoice in relation to that supply as if that agent had made the supply, and provided that the principal shall not issue a Tax Invoice'*. However, this rule hardly makes an excuse for UAE Co. because the Merchant included in the Rules of Services a provision against agency treatment.

Article 50 of the [VAT Executive Regulation](#) makes agents responsible for declaring and paying VAT on sales of a principal to unregistered

⁹ Sec. 9.4 of the E-Commerce Guide.

¹⁰ Art. 7 (1) of [Cabinet Decision No. 52 of 2017](#)

customers. However, this rule applies (i) to an agent and (ii) for importing of goods rather than services; thus, such rule not applicable in this case.

- 2) Supplies to foreign users should be treated as an e-commerce supply with the Place of Supply (place of use and enjoyment) situated outside of the UAE¹¹. Such supplies are outside the scope of UAE VAT. They don't count towards the registration threshold and shouldn't be included in the VAT return either before or after registration. A tax invoice is not required for such a supply in terms of UAE VAT.

Alternative option

20. Notwithstanding the above, based on the wordings of the contractual arrangement with the Merchant, the FTA may challenge the above substance-based approach and allege that UAE Co. derives income from providing the license to the Merchant to distribute the software.

This supply of the licenses should not be viewed as the supply of e-services, since the Merchant does not enjoy the supplied software, but merely receives the right to distribute and sell the software to end users, who will use and enjoy the software.

This may lead the FTA to the conclusion that the Place of Supply for all (worldwide) sales via the Merchant is in the UAE, which leads to the following consequences:

- 1) UAE Co. will need to count **all** supplies of licenses to the Merchant towards the AED 375,000 threshold for the mandatory VAT registration and to register for VAT in the UAE where the threshold is exceeded;
- 2) the 0% VAT rate should be available for sales in other markets;
- 3) the 5% rate applies to supplies to actual recipients located in the UAE.

This scenario entails enhanced VAT compliance implications for UAE Co.

One more alternative

21. Alternatively, the FTA may treat the Merchant as a reseller or a commissioner selling the license in its own name but on behalf of UAE Co. (undisclosed agent treatment). Simply put, the FTA may accept the self-declared status of undisclosed agent without any reclassification.

We believe that, in this treatment, the Place of Supply would be determined as the place of the actual use (enjoyment) of the software for both the principal and the Merchant.

Under this treatment:

¹¹ Article 31 of the [UAE VAT Law](#).

- 1) Licenses sold for use in foreign markets will not count towards the registration threshold (unlike the treatment of Merchant as purchases of rights for the distribution of the software).
- 2) UAE Co. doesn't fall under the burden of compliance with zero-rating conditions.
- 3) If the registration threshold of AED 375,000 is exceeded as a result of the sales of licenses to customers in the UAE, UAE Co. will apply the 5% VAT rate on sales of the software to UAE users, and will apply the zero-rate to sales to users in foreign markets. UAE Co. should issue Tax Invoice to the Merchant and the letter would be generally allowed to recover it.

On balance

22. As established above, the treatment of supplies made via the Merchant involves a high level of uncertainty. The FTA could treat them as direct sales to end-users, or the sale of a license for the distribution of the software, or a resale or a sale via an undisclosed agent.

If such treatment differs from the one chosen by UAE Co., a dispute will ensue. Therefore, prior to UAE Co. engaging with the Merchant, we recommend obtaining certainty in this matter by receiving a preliminary ruling ([private clarification](#)) from the FTA.

The disclaimer

Pursuant to the [MoF's press-release](#) issued on 19 May 2023 "a number of posts circulating on social media and other platforms that are issued by private parties, contain inaccurate and unreliable interpretations and analyses of Corporate Tax".

The Ministry issued a reminder that official sources of information on Federal Taxes in the UAE are the MoF and FTA only. Therefore, analyses that are not based on official publications by the MoF and FTA, or have not been commissioned by them, are unreliable and may contain misleading interpretations of the law. See the full press release [here](#).

You should factor this in when dealing with this article as well. It is not commissioned by the MoF or FTA. The interpretation, conclusions, proposals, surmises, guesswork, etc., it comprises have the status of the author's opinion only. Furthermore, it is not legal or tax advice. Like any [human](#) job, it may contain inaccuracies and mistakes that I have tried my best to avoid. If you find any inaccuracies or errors, please let me know so that I can make corrections.

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