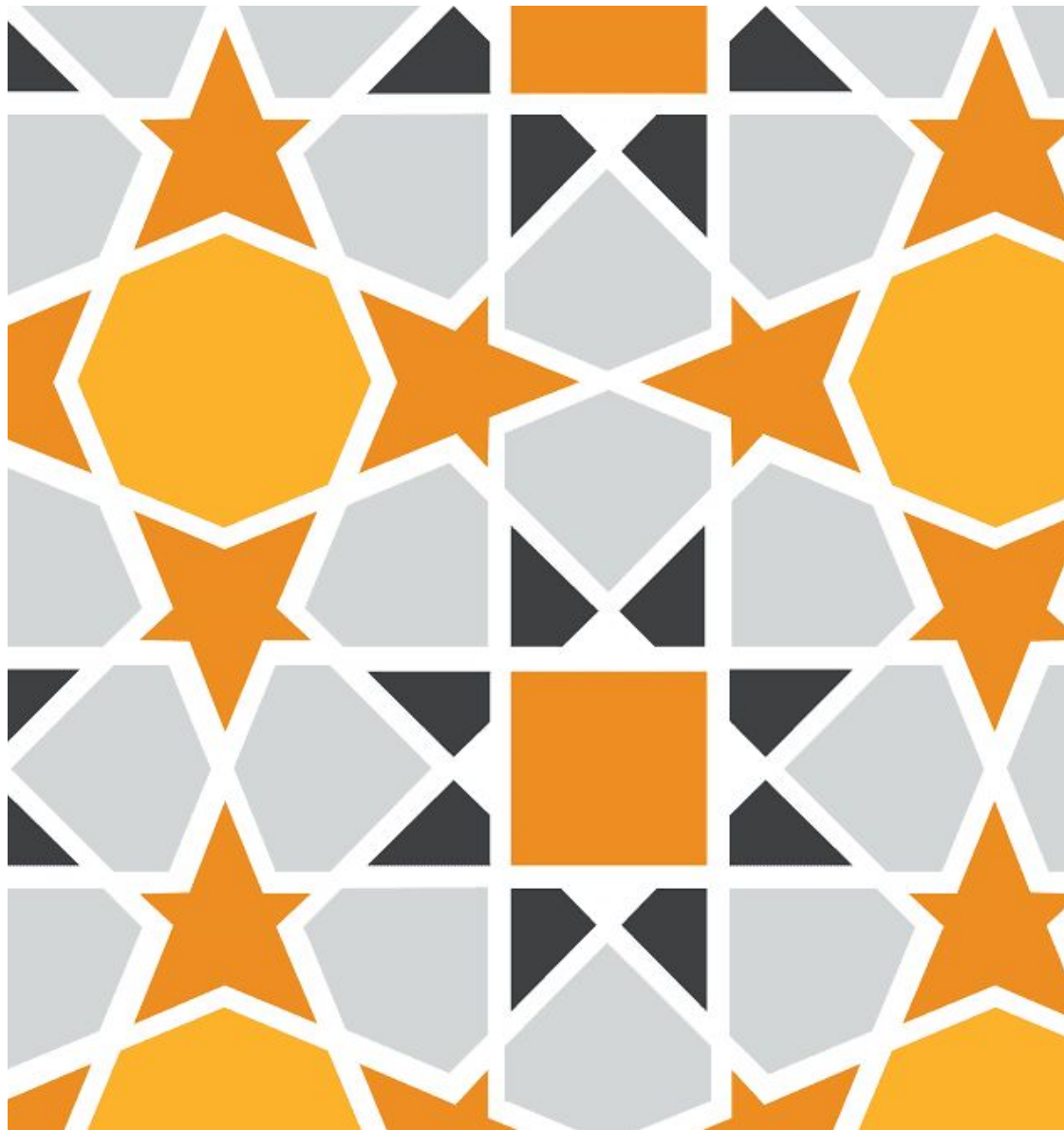


# Saudi Arabia: Circular on Real estate VAT exemption and the impact on proportional deduction calculation

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## In brief

The Zakat, Tax and Customs Authority ('ZATCA') published a Circular on its official website explaining the impact of real estate VAT exemption on proportional deduction calculation.

The Circular, issued in Arabic at the moment, also highlights areas such as the alternate mechanism for calculating the proportional deduction ratio in real estate financing cases, and can be accessed [here](#).

## In detail

Effective 4 October 2020, the VAT treatment on the supply of real estate made by a taxable person in KSA was changed from a standard rated taxable supply to a VAT exempt supply pursuant to Royal Decree No. (A/84) issued on Safar 14, 1442 H (the disposal of real estate became subject to a real estate disposal tax at 5% of the total disposal value of the property).

The above change resulted in an increase in the value of exempt supplies that a taxpayer has to use to calculate its proportional deduction ratio for computing residual input VAT. Residual input VAT represents input taxes which relates to both taxable and exempt supplies made by a taxpayer.

### Proportional Deduction method

In accordance with the provisions of Article 51 of the VAT Implementing Regulation, a taxable person who is making both taxable and exempt supplies for VAT purposes in KSA need to apply the default proportional deduction method in order to calculate the residual input VAT it may claim.

The change in the VAT treatment of real estate sales from taxable to exempt impacts the default computation of the proportional deduction, resulting in an overall decrease in the proportional deduction ratio and a lower claim for the residual input VAT. As a result, more VAT amount becomes a business cost.

### Impact on the Banks and Financial Institutions

ZATCA clarified that Banks and financial institutions involved in the provision of Islamic finance products (that include the purchase and sale of real estate) have undoubtedly been affected by the above change.

In this regard, ZATCA believes that the objective of Banks and financial institutions is to provide financing to their customers instead of selling real estates. Real estate is usually purchased and sold by Banks and financial institutions in accordance with the principles of Sharia-compliant financing.



Exempt supplies of real estate made by financial institutions, as part of shariah compliant financing, may be disregarded to calculate proportional deduction ratio.





## Alternative proportional deduction method

The provisions of Article 51 of the VAT Implementing Regulations also allow a taxpayer to submit an alternative proportional deduction method to ZATCA where such an alternative method provides more accurate values for input VAT recovery for residual tax.

ZATCA, upon review of the alternative proportional deduction method proposed by an applicant, may approve or reject such method.

ZATCA clarified in this Circular that for real estate exempt supplies provided by banks and financial institutions as part of their financing activities, the alternative mechanism is the same as the default mechanism, with the exception that real estate supplies would be excluded from the value of exempt supplies from the denominator in order to calculate the proportional deduction ratio. It is to be noted that taxpayers still have to get approval on using the alternative proportional deduction method from ZATCA.

For the purpose of applying the alternative proportional deduction method, the real estate financier must fulfill the following conditions:

- Should be a taxable person.
- Should be a bank or financial entity to provide real estate financing licensed by the Central Bank of Saudi Arabia.
- Should make supplies of Sharia-compliant financing products that include the purchase/sale of real estate to the beneficiary of the financing.

## Business impact on banks and real estate financiers

Banks and/or financial institutions involved in the provision of Islamic finance products should review their VAT apportionment in order to benefit from a lower VAT cost.

Should you have further questions and or are in need of assistance, please reach out to us through contact persons mentioned in this alert.

# The takeaway

Taxpayers engaged in making mixed supplies (taxable and exempt including those engaged in real estate financing) are encouraged to carefully examine the content of this Circular in order to assess their existing practice of proportional deduction calculations.

Due consideration should be given to prepare and submit an application for alternative proportional deduction method where the default method does provides accurate values for input VAT recovery for residual input VAT.

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## Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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# Thank you

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