Tax tips | Value of property and partial exemption calculations

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keypoint

In the latest version of its real estate guidelines, published 17 June 2021, Saudi Arabia's *Zakat*, Tax and Customs Authority (ZATCA) has clarified that licensed real estate financiers may exclude the value of property assets in financing arrangements from their partial exemption calculations. This may significantly impact Islamic financial institutions (IFIs) - as well as other asset-backed financing arrangements.

What's the background?

- In mid-2019, a number of clarifications on VAT and Islamic finance - with asset-backed arrangements establishing IFIs as both buyers and sellers of assets - exposed IFIs to some significant tax charges.
- The inclusion of these transactions in IFIs' partial exemption calculations significantly boosted their recovery rates - sometimes by more than 15%. However, on 4 October 2020, supplies of land and property were declared VAT-exempt, negatively impacting residual recovery rates.
- ZATCA has now clarified that licensed real estate financiers can exclude sales of exempt land and property from their residual VAT recovery calculations - although sales of land and property still need to be declared and directly attributable costs remain irrecoverable.
- With this change, ZATCA seems to have pre-approved an alternative method of VAT recovery for IFIs supplying exempt land and property.

Issues to consider

- How should retrospective declarations be treated?
- How does this clarification impact partial exemption calculations?
- How does the retrospective removal of taxable supplies of land and property (before 4 October 2020) impact IFIs?
- How does this clarification impact other non-property Islamic financing arrangements - such as auto *ijarah*?

What should key decision-makers at IFIs do now?

- This clarification looks positive for IFIs with large property financing operations, who should see partial exemption recovery improve.
- IFIs may wish to review 2020 recoveries, which could also impact 2021 provisional recovery rates - although clarifying whether this is allowed with ZATCA seems sensible.
- Key decision makers should explore questions which remain over application before 4 October 2020 - and its impact on other non-property Islamic financing arrangements.

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