

Tax Alert | Significant update to the VAT Treatment of Virtual Assets

October 24, 2024



Introduction

- » The UAE Cabinet has issued **Decision No. 100 of 2024**, amending various provisions of the UAE VAT Executive Regulations. One of the most significant updates affects businesses dealing with **virtual assets**, such as cryptocurrencies and non-fungible tokens (NFTs).
- » While most of the amendments to the Regulations take effect from 15 November 2014, key updates concerning virtual assets **apply retroactively from 1 January 2018**.
- » This alert provides an overview of how these amendments affect businesses operating in the virtual assets space.



Key Updates

- » The amendments to Article 42 of the UAE VAT Executive Regulations now classify certain transactions involving virtual assets as financial services. Furthermore, effective from 1 January 2018, the trading or conversion of virtual assets is treated as an **exempt financial service**.
- » This significant update will impact input tax recovery, as well as the registration and reporting requirements for businesses involved in virtual assets.

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Overview of the amendments

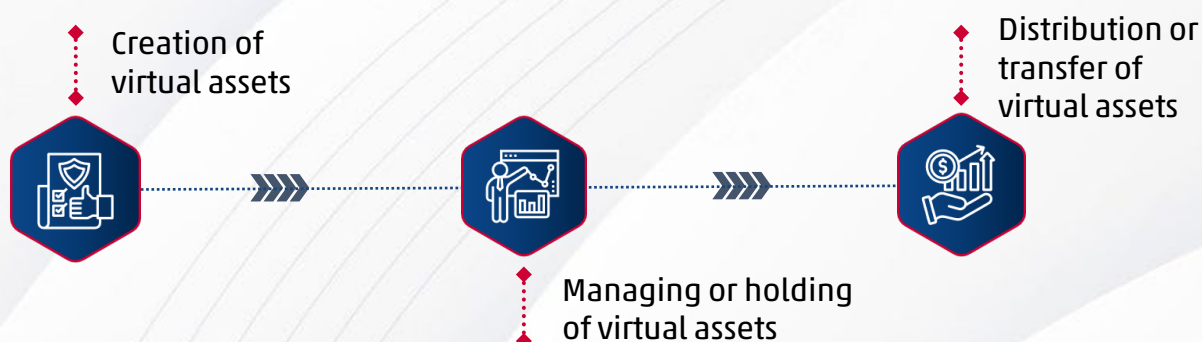
- » **Virtual assets:** The Regulations define virtual assets as digital assets which can be traded, converted, and used for investment purposes. This, however, does not include any digital representations of fiat currency or financial securities.
- » **Transactions with Virtual assets are now treated as financial services:** Pursuant to the amended Article 42(2) of the Executive Regulations, the following transactions are now classified as financial services:
 - k. The transfer of ownership of Virtual Assets, including virtual currencies*
 - l. The conversion of Virtual Assets*
 - m. Keeping and managing Virtual Assets and enabling control thereof*

- » **Exempt supply:** While the scope of financial services now includes the aforementioned transactions, it is important to highlight that the amended provisions of Article 42(3) has explicitly mentioned that **only “(k) the transfer of ownership of virtual assets” and “(l) conversion of virtual assets” will be treated as exempt supplies by default.** Further, the exempt treatment for these supplies is effective retrospectively **from 1 January 2018.**

In contrast, the service of **“(m) Keeping and managing Virtual Assets and enabling control thereof”** will follow the general tax treatment for financial services and thus may either be subject to 5% VAT or exempt, depending on whether or not consideration for the services is charged in the form of an explicit fee or commission. If the service is provided for an implicit margin then it will be exempt. We note that this treatment appears to take effect only from **15 November 2024**, and therefore it is arguable that any fee chargeable before 15 November 2024 would be taxable under the general VAT rules.

- » **Input tax recoverability:** Input tax incurred in relation to exempt supplies is not recoverable. While businesses dealing with virtual assets will benefit from the exemption on their transactions, they will be unable to recover input tax on related expenses, meaning that input VAT would become a cost for businesses in this sector. Furthermore, since the exemption is effective from 1 January 2018, businesses that have previously recovered input VAT on related expenses may be required to reverse those amounts.
- » **Zero-rated treatment:** It is important to note that when any financial services, including the transfer of ownership, conversion, or keeping and managing of virtual assets, are supplied to recipients outside the UAE, they may qualify for zero-rating provided all conditions in Article 31 of the Executive Regulations are met. Input tax incurred on such zero-rated supplies can be recovered.
- » **Reverse Charge:** There may be instances where fees are paid for services acquired from outside the UAE, such as platform trading fees, insurance premiums for insuring virtual assets, or expenses related to mining virtual assets. When these expenses are treated as the import of services, they may be subject to UAE VAT under the reverse charge mechanism. Given that dealing in virtual assets in the UAE is considered an exempt supply, this could impact the recoverability of input tax on such expenses.
- » **VAT deregistration:** Businesses solely engaged in trading or conversion of virtual assets should assess whether VAT deregistration is required. However, if they import goods or services, they may still need to register for VAT and account for the VAT under the reverse charge mechanism, which could result in an additional VAT cost.

- » **Virtual assets:** The term 'virtual assets' excludes any digital representations of fiat currency or financial securities. This raises a question of whether Central Bank Digital Currency (CBDC) and stablecoins qualify as virtual assets for VAT purposes. Since CBDCs are digital forms of a country's fiat currency, they should fall outside the definition of a virtual asset. In contrast, while stablecoins are designed to maintain a stable value by pegging to stable assets such as fiat currencies, they are not, strictly speaking, digital representations of fiat currency. Therefore, stablecoins are likely to be classified as virtual assets for VAT purposes.
- » **Transitional rules:** The FTA has yet to provide guidance on the transitional application of the amendments. Due to the absence of rules and guidance for the sector prior to the amendments, some businesses registered for VAT may have recovered input tax on expenses related to virtual assets or accounted for VAT on supplies of virtual assets. Given that the amendments concerning the exemption for transfer and conversion of virtual assets are effective from 1 January 2018, the FTA may need to clarify whether adjustments or voluntary disclosures will be required for alternative treatments adopted in prior periods.
- » **Virtual assets lifecycle:** Usually, virtual assets go through three distinct phases in their lifecycle, as outlined below.



As illustrated above, the recent update only addresses specific phases in the lifecycle of virtual assets, namely the second and third phases. The amendment notably does not cover the VAT treatment for the origination or creation of these assets, such as **crypto mining, token issuance, airdrops, and initial coin offerings ('ICO')**. This omission creates uncertainty for businesses undertaking these activities.



Way forward

Given the recent update to the VAT treatment of virtual assets, businesses involved in these activities should consider taking **the following actions**:

- » Review prior-period transactions to assess the VAT implications of supplies.
- » Evaluate **input tax recoverability** and determine the need for input tax apportionment and annual adjustments.
- » Assess **VAT deregistration implications**.
- » Conduct a **cost-benefit analysis**, including the impact of blocked input tax, to determine if contractual changes are necessary.
- » Ensure **full VAT compliance** with the updated VAT Executive Regulations.

Conclusion

The inclusion of virtual assets in the recent VAT amendments represents a significant step toward providing clarity and simplifying regulatory and compliance requirements for businesses in the virtual space. This is expected to attract more investment into the UAE's digital asset market, further solidifying its position as a global hub for digital and crypto industries.

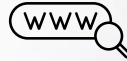
If you have any questions or would like to discuss how these VAT amendments impact your business, please do not hesitate to reach out to our team.

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