

Tax Alert | Significant update to the UAE VAT Executive Regulations impacting the fund management sector

October 14, 2024



Introduction

- » The UAE Cabinet has issued **Decision No. 100 of 2024** which amends various provisions of the UAE VAT Executive Regulations. These amendments mark a significant shift in the UAE VAT framework and will take effect from **15 November 2024**, unless stated otherwise.
- » In this alert, we focus on the amendments affecting **the fund management sector**. These changes significantly impact the VAT obligations of **fund managers** and **funds** in the UAE.



Key updates

- » The recent amendments to Article 42 of the UAE VAT Executive Regulations reverse the previous position that services related to the **management of investment funds** should be treated as standard-rated supplies. Effective 15 November 2024, fund management services provided to **funds licensed by a competent authority in the UAE** will be classified as **exempt financial services**.
- » This fundamental change will impact input tax recovery, registration requirements, and overall fund management structures.

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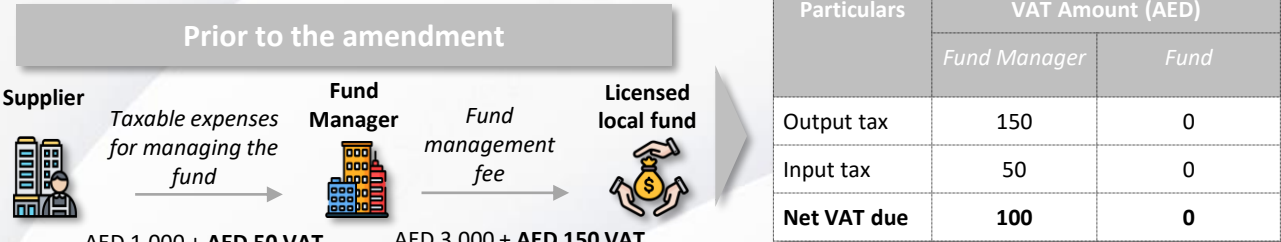
Overview of the amendments

- » **Exempt supply:** Fund management services provided to local funds licensed by a competent authority will be exempt.
- » **Input tax recoverability:** Input tax incurred in relation to exempt supplies is not recoverable. While fund managers will benefit from the exemption on their services, this change limits their ability to recover input tax on the related expenses. As a result, fund managers need to evaluate how this impacts their profits.
- » **Licensed funds:** The exemption for fund management services applies only to services provided to funds licensed by a competent authority in the UAE; services to unlicensed funds remain taxable at 5% (unless it can be zero-rated).

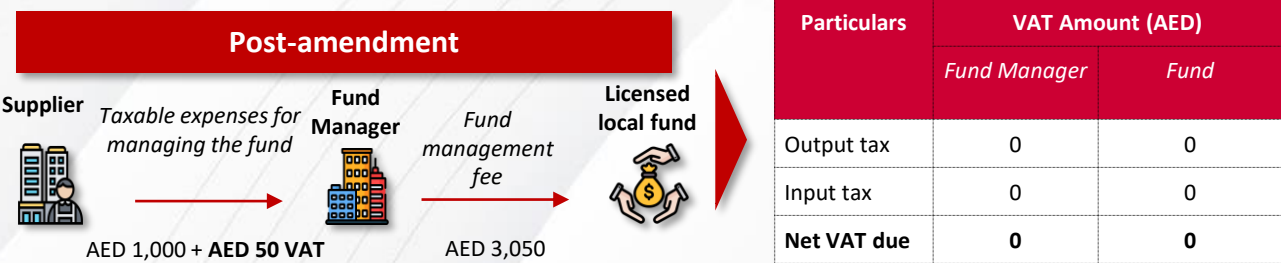
- » **VAT deregistration:** Fund managers solely providing exempt services to licensed local funds should assess whether VAT deregistration is necessary. However, if they import services, then they may still be required to register for VAT and account for VAT under the reverse charge mechanism. This could result in an additional VAT cost.
- » **Zero-rating treatment:** Fund management services provided to funds located outside the UAE may qualify for zero-rating provided all conditions in Article 31 of the Executive Regulations are met. Input tax incurred towards such zero-rated supplies can be recovered.

2 Implications of the amendments – illustration

Below is an illustration of the amendments to the tax treatment of fund management services and their related impact on input tax recoverability for both the fund manager and the fund.



- » From the fund manager's perspective, VAT is charged on fund management fees, and input tax is recovered on expenses incurred for managing the fund.
- » On the other hand, VAT incurred by the fund on fund management services is treated as cost in the P&L (non-recoverable input tax) as it does not relate to any taxable supplies.



- » As a result of the amendments, the VAT payable by the fund manager is reduced. However, the added cost of non-recoverable input tax on fund management expenses may lead the fund manager to incorporate this cost into the fund management fees charged to the fund.
- » For the fund, the impact of non-recoverable input tax on fund management services is eliminated. However, as mentioned above, fund management fees charged by fund managers may increase.

Based on the illustration provided, the following should be noted:

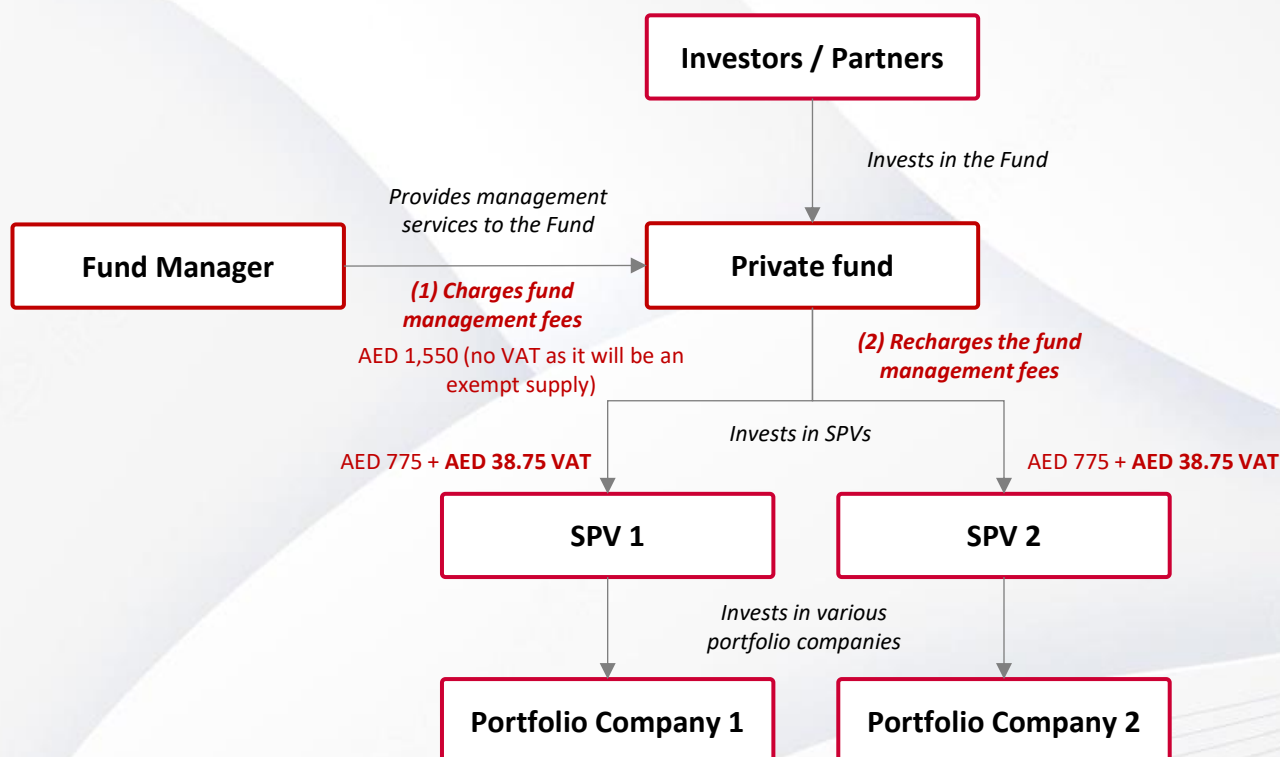
- » **Reduction in VAT cost:** The pre-amendment VAT cost for the fund was AED 150, compared to AED 50 VAT cost for the fund manager following the amendment.
- » **Mark-up impact:** The overall reduction in VAT cost is attributed to the mark-up charged by fund managers on their expenses. In the illustration, the fund manager's mark-up is AED 2,000 (AED 3,000 less AED 1,000). As a result, the VAT cost reduction is AED 100 (AED 2,000 * 5%).
- » **Shift in VAT cost:** VAT will continue to be a cost in the fund structure. However, the impact of non-recoverable input tax now falls on the fund manager.
- » **Adjustment of management fees:** Where possible, fund managers may adjust their pricing to account for the cost of non-recoverable input tax.

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Key points requiring further clarification

- » **Licensing requirements:** A key condition for qualifying as fund management services is that the services must be provided to funds "licensed by a competent authority in the UAE." Currently, it remains unclear whether commercial licenses issued by financial free zones, such as Dubai International Financial Center (DIFC) or Abu Dhabi Global Market (ADGM), to limited partnership funds would fulfill the criteria. Additionally, a license issued by the Securities & Commodities Authority (SCA) to public funds would appear to meet these criteria. However, further clarification from the FTA on these conditions is required.
- » **Transitional rules:** The FTA has yet to provide guidance on the transitional application of the amendments effective from 15 November 2024. This may be particularly relevant in the following sample scenarios:
 - » Advance invoicing or payment for services performed after 15 November 2024.
 - » Services performed prior to 15 November 2024 but only invoiced and/or paid after 15 November 2024.
 - » One-off supplies of fund management services.
- » **Typical private fund structure:** Often, funds invest in ventures through Special Purpose Vehicles (SPVs). Furthermore, fund management fees incurred by funds may be recharged to these SPVs. It remains unclear whether these onward recharges of fund management fees to SPVs will also qualify for exemption.

- » Typical private fund structure (*cont'd*): This typical private fund structure is illustrated below.



- » As illustrated above, fund management services provided by the fund manager to the licensed local fund will be exempt from VAT. However, the onward recharge of these fund management fees to the SPVs may be subject to VAT at 5%, as SPVs may not qualify as licensed local funds (pending further clarification from the FTA). Additionally, these SPVs may not be eligible to recover the input tax, as they are not engaged in making taxable supplies.
- » As a result, in such structures, the VAT cost will ultimately rest at the SPV level, as outlined below:
- » From the fund's perspective, the inputs are incurred without VAT; however, the onward recharges to the SPVs may be subject to VAT at 5% (unless the SPV qualify as licensed funds).
 - » Consequently, the non-recoverable VAT cost will be borne by the SPVs. In this example, the SPVs bear a total VAT cost of AED 77.50.



Way forward

In light of the recent amendments to the VAT treatment of fund management services, funds and fund managers SHOULD consider the following action points:

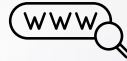
- » Revisit **licensing requirements for funds** in order to be eligible for the VAT exemption.
- » Assess **VAT deregistration implications** for fund managers that are solely engaged in providing services to licensed local funds.
- » Review **input tax recoverability for fund managers** and assess the need for input tax apportionment and annual wash-ups.
- » Conduct a **cost-benefit analysis**, including the impact of blocked input tax at the fund manager level to determine if contractual changes are necessary.
- » Ensure **overall VAT compliance** with the updated VAT Executive Regulations, including the proper application of transitional principles.

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