VAT

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Tax Treatment

Real Estate Loan Portfolios Insurance

October 2022

The Zakat, Tax and Customs Authority ("ZATCA", "Authority") has issued this Tax Circular for the purpose of clarifying certain tax treatments concerning the implementation of the statutory provisions in force as of the Circular's issue date. The content of this Circular shall not be considered as an amendment to any of the provisions of the Laws and Regulations applicable in the Kingdom.

Furthermore, the Authority would like to highlight that the clarifications and indicative tax treatments prescribed in this Circular, where applicable, shall be implemented by the Authority in light of the relevant statutory texts. Where any clarification, interpretation or content provided in this Circular is modified - in relation to unchanged statutory text - the updated indicative tax treatment shall then be applicable prospectively, in respect of transactions made after the publication date of the updated version of the Circular on the Authority›s website.

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1. Definitions:

Terms and phrases contained in this Circular shall have the meanings ascribed to each of them unless the context requires otherwise:

A. The Kingdom: The territory of the Kingdom of Saudi Arabia, including the areas located outside the territorial waters in which the Kingdom of Saudi Arabia practices the rights of sovereignty over its water, the seabed, the layers under the soil and natural resources, pursuant to its laws and international law.

B. Authority: Zakat, Tax and Customs Authority (ZATCA).

C. Tax: Value Added Tax (VAT).

D. Law: Value Added Tax Law issued by Royal Decree No. (M/113) Dated 2 / 11 / 1438H, and amendments related.

E. Implementing Regulations: Value Added Tax implementing regulations issued by the Authority decision No. (3839) dated 14 / 12 / 1438H, and amendments related.

F. The Unified Agreement: The Unified Agreement for Value Added Tax for the Cooperation Council for Arab States of the Gulf issued in November 2016.

G. Circular: Tax Circular for VAT treatment of Real Estate Loan Portfolios Insurance.

H. Nominal Supplies: Anything that is considered a Supply in accordance with the cases provided for in Article 8 of the Unified VAT Agreement.

I. Financial Institution: Any natural or legal person subject to the supervision, oversight, and regulation of the Saudi Central Bank [1].

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(1) Article (1) of Saudi Central Bank Law issued by Royal Decree No. M/36 dated 26 November 2020 .

2. Circular Subject

This circular aims to provide information and guidance on the VAT treatment of real estate Loan portfolios insurance procured by the financial institutions for carrying out real estate financing activities.

The circular is based on the interpretation of the Common VAT Agreement of the States of the Gulf Cooperation Council ("GCC VAT treaty"), VAT Law (the "Law") and the Implementing Regulations of the VAT Law (the "Regulations").

3. Overview

Financial institutions which offer or provide real estate loans to their customers may procure insurance policies to insure against real estate finance risks in the Kingdom. This may be as a regulatory requirement -for instance- in accordance with the regulations provided by the Saudi Central Bank (SAMA), and the relevant provisions.

4. VAT treatment of the supply of Real Estate Loan Portfolios Insurance

Financial institutions purchase insurance for real estate loan portfolios to cover from risks related to real estate finance. Typically, the insurance policy would cover a portfolio of loans, or the entire real estate portfolio of a financial institution.

All supplies of insurance in the Kingdom, except for life insurance, are subject to VAT at the standard rate, accordingly, the supply of real estate loan portfolios insurance by a KSA insurer licensed by the Saudi Central Bank (SAMA) to a financial institution is subject to VAT at (15%). The insurers must issue a tax invoice and account for Output Tax on their supply.

5. Deduction of input tax incurred by the financial institutions

As a general principle, any VAT incurred by a taxable person on the purchase of goods or services supplied to him is deductible, provided they are used in carrying out an economic activity in the course of making taxable supplies. The taxable person is required to obtain and retain a tax invoice to document the input VAT amount paid or payable.

Applying this to the input tax incurred by the financial institutions on the purchase of real estate Loan portfolios insurance, the first step is to determine the recipient of the supply (Customer). In other words, an evaluation is required to assess whether the Customer of the insurance is the financial institution that has purchased the insurance, or another person such as the borrower(s).

5.1. Normally, the identification of the Customer is a straightforward matter. However, this assessment of who receives a supply of goods or services may be more complex in cases where the contractual recipient of the supply is different from the person who benefits from the supply. Accordingly, a customer is defined for VAT purposes as a person who receives goods or services, and under the general principles of VAT, the customer is usually identified through contractual arrangements, including:

- The person who instructs the supplier to supply the goods or services;
- The person who enters into a contract with the supplier;
- The person who has the authority to require the supplier to fulfill and comply with its contractual obligations regarding the supply of goods or services.

5.2. In the case of the real estate loan portfolios insurance, ZATCA considers that the financial institutions should be considered the Customer provided the following facts apply:

- The financial institutions enter into the insurance contracts directly with the insurers;
- The financial institutions pay the insurance premium themselves and on their own account;
- The insurance contracts cover the entire real estate loan portfolios.
- The financial institutions are entitled to make a claim against the insurer upon occurrence of the insured event and accordingly benefit from the insurance.

On the basis that the financial institutions are the Customer of the supply and incur the insurance costs in the course of their economic activities, they are entitled to deduct the input tax to the extent it is attributable to the making of taxable supplies.

5.3. In a real estate finance arrangement, the financial institutions typically make both taxable supplies, as well as exempt supplies (such as financial services resulting in interest or profit margin). Accordingly, the input tax incurred by the financial institutions is deductible on the following basis:

Input tax directly attributable to taxable supplies	Deduction in full
Input tax directly attributable to exempt supplies	No deduction
Input tax that cannot be directly attributed to taxable or exempt supplies (overheads)	Partial deduction based on apportionment

If the real estate loan portfolios insurance cannot be directly attributed to taxable supplies or exempt supplies, the input tax deduction will be based on the above to accurately reflect the use of the insurance costs in the taxable portion of the financial institution's supplies.

The input tax deduction position is based on the facts confirming that the financial institutions are the Customer and the recipient of the supply. Where the facts of the transaction are not consistent with those in paragraph [5.2] of this Circular (for example, if the financial institutions only pay for the insurance but the borrowers are entitled to claim proceeds), the financial institutions may not be entitled to deduct the input tax because in such a case the insurance is, in essence, received by the borrowers.

It should be noted that the contractual arrangements and the underlying circumstances should be carefully reviewed by the financial institutions to clearly establish that the criteria are met, and that they are indeed the Customer and the recipient of the supply.

6. The extent to which financial institutions make an onward supply or nominal supply of insurance to the borrowers

Generally, financial institutions purchase such insurance services to insure their potential risks arising from the supply of real estate financing products to their customers. It should be noted that the requirement to procure real estate Loan portfolios insurance may often be a regulatory requirement prescribed by Saudi Central Bank (SAMA). In all cases, the procurement of real estate Loan portfolios insurance is a cost incurred by the financial institution for carrying on the Economic Activity.

Typically, real estate finance products do not involve the provision of insurance cover or any comparable assurance, security or undertaking to the borrower. And where that the financial institutions incur a portfolio insurance expense and do not charge customers any specific amount to recoup the insurance costs, that›s because that these services benefit the financial institution to insure its potential risks, and are not supplied to the customers with or without consideration (nominal supply).

Provided that insurance forms part of the general cost base of the insurer, and the insurer does not provide any form of insurance to the customer, ZATCA considers that the financial institutions do not make any supply of insurance to their borrowers. As such, no Output Tax obligation arises for the financial institutions in respect of the insurance purchased.

Lastly, where a financial institution charges a separate amount to the borrowers to recoup the insurance costs, such a charge will be subject to VAT at the standard rate.

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