Baker McKenzie.

Client Alert

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United Arab Emirates: VAT Executive Regulation Amended

Key changes to input tax recovery, composite supplies and compliance obligations

In brief

The UAE Cabinet has issued Cabinet Decision No. 149 of 2026, amending the Value Added Tax (VAT) Executive Regulation. Most changes take effect from 1 October 2026 and affect the treatment of composite supplies, employee-related costs, healthcare goods, cash payments, the Profit Margin Scheme and the Capital Asset Scheme. Revised input tax apportionment rules will apply from the first tax year commencing after 1 October 2027. Businesses should assess how the amendments affect existing VAT positions, contracts, policies, systems and supporting records.

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Recommended actions

- Review bundled goods and services to confirm whether the VAT treatment reflects the commercial arrangement as a whole.
- Check employment contracts, HR manuals and documented benefit policies supporting input VAT recovery, particularly for accommodation.
- Identify material cash payments and monitor the Ministerial decision that will set the non-recovery threshold and conditions.
- Model the revised input tax apportionment calculation, particularly for financial institutions, insurers, investment managers and real estate businesses.
- Review VAT coding and records for healthcare goods, Profit Margin Scheme purchases and capital assets.

In more detail

Composite supplies: focus on the commercial arrangement

A new provision clarifies that a taxable person cannot treat a supply as multiple supplies where the nature and economic substance of the arrangement indicate that the components are interconnected and cannot be separated.

In that case, the arrangement must be treated as a single composite supply and follow the VAT treatment of its principal component.

The existing rules already require taxpayers to consider the contract and the wider circumstances of the supply. The amendment adds a clear restriction on treating interconnected components as separate supplies. This reinforces the need to assess the overall commercial arrangement rather than focusing solely on contractual descriptions or pricing mechanics.

The change is relevant to businesses that sell packages of goods and services, including technology providers combining licences, implementation and support; hospitality operators providing accommodation with related services; healthcare providers offering treatment packages; educational institutions supplying tuition and related materials; and real estate businesses providing property, fit out or management services.

Businesses should review product and service bundles, contracts, price schedules, invoicing and tax coding. Separate descriptions or pricing remain relevant, but businesses should assess whether the customer is receiving a single principal supply or multiple independent supplies when viewed in the context of the arrangement as a whole.

Employee related costs: recovery opportunities and evidence

The amendments revise the exceptions to the restriction on input VAT recovery for goods and services provided to employees without charge for their personal benefit.

Input VAT may be recoverable where the benefit is mandatory under applicable labour legislation in the UAE or a free zone. Recovery may also be available where the benefit is provided under a contractual obligation or documented policy, subject to the cases and conditions specified by the Federal Tax Authority (FTA).

The revised wording may support input VAT recovery where the employer can demonstrate a legal, contractual or documented obligation to provide the benefit. The changes place greater emphasis on maintaining contemporaneous documentation that evidences the obligation. Benefits provided as a matter of practice, but not supported by contractual terms or documented policies, may be more difficult to defend during an FTA review.

Employers should review employment contracts, offer letters, HR manuals, employee handbooks, benefit policies and approval records. The documents should clearly identify the benefit, the employees who qualify, the business rationale and whether the employer is required to provide it.

Employee accommodation: a narrower rule

The amendment expressly states that the labour legislation exception does not include accommodation provided by an employer unless the accommodation is mandatory under decisions or directives issued by the Ministry of Human Resources and Emiratisation.

The change is likely to be most relevant for construction, energy, manufacturing, logistics, facilities management and other labour-intensive sectors where employee accommodation represents a significant cost. Providing accommodation under a contract or internal policy may not, by itself, satisfy the specific accommodation requirement.

Businesses recovering input VAT on employee accommodation should identify the relevant legal or regulatory requirement and retain evidence that the requirement applies to the employees and accommodation concerned. Businesses currently recovering input VAT on accommodation should reassess whether the recovery position remains supportable in light of the amended wording.

Cash payments: future restriction on input VAT recovery

A new provision permits the Minister to prescribe circumstances in which input VAT cannot be recovered on higher value transactions that are paid, or intended to be paid, in cash. The applicable threshold and detailed controls have not yet been issued.

The practical impact will depend on the threshold and conditions set out in the future Ministerial decision. The amendment nevertheless creates a clear need for businesses to understand where cash is used in procurement and whether those payments could fall within the restriction.

Retail, hospitality, transportation, construction subcontracting and trading businesses may have greater exposure where cash payments remain part of normal operations. Taxpayers should map material cash payments, review payment approval processes and consider using traceable payment methods where commercially feasible.

Healthcare goods: revised scope of zero rating

The zero rating provision for healthcare goods is revised to cover medical products specified in a Cabinet decision and other goods supplied in the course of providing zero rated healthcare services where those goods are necessary for the healthcare services.

The existing provision separately refers to pharmaceutical products and medical equipment specified by Cabinet decision. The revised wording consolidates the categories into a single reference to “medical products” specified by Cabinet decision.

Hospitals, clinics, pharmacies, medical distributors and other healthcare businesses should monitor the Cabinet decision identifying qualifying medical products. They should then compare the approved categories with existing product master data, VAT codes and invoicing treatment. Healthcare providers should also review whether goods supplied alongside treatment meet the requirement of being necessary for the provision of the qualifying healthcare service.

Input tax apportionment: a new supplies based formula

For many partially exempt businesses, the most significant amendment is the replacement of the current standard apportionment methodology.

Under the amended rules, the recoverable percentage will be calculated by comparing the value of supplies carrying a right to input tax recovery with the value of all supplies. The percentage will be rounded to the nearest whole number and applied to residual input VAT that relates partly to supplies carrying a right to recovery and partly to other supplies.

Capital asset disposals and the receipt of concerned goods and concerned services under the reverse charge mechanism will be excluded from the supplies based percentage. Separate calculation rules will apply to Government Entities and Charities.

The revised rules take effect from the first tax year commencing after 1 October 2027. The commencement date will therefore vary depending on the taxpayer's VAT tax year.

The revised formula may result in materially different recovery outcomes compared with the current methodology. The impact will depend on the value and composition of taxable, zero rated, exempt and other supplies and the level of residual expenditure. Financial institutions, insurers, investment managers, holding companies and mixed use real estate businesses should model the amended formula using historic and forecast data.

Taxpayers using an FTA approved alternative method should review the terms and continuing suitability of that method. Businesses applying the standard method should also consider whether the supplies based calculation fairly reflects actual use or whether an alternative method application may be appropriate.

Profit Margin Scheme: treatment of purchase costs

For the Profit Margin Scheme, the purchase price will include costs and fees incurred to purchase the goods only where input VAT on those costs or fees is not recoverable under the VAT Law.

The amendment prevents recoverable VAT bearing costs from increasing the purchase price used to calculate the taxable margin. Dealers in second hand goods, antiques and collectors items should review how acquisition fees, commissions and other purchase related costs are included in margin calculations.

Taxpayers should ensure that records distinguish between costs carrying recoverable input VAT and costs for which input VAT is not recoverable. Businesses should ensure that margin calculations are applied consistently across purchase documentation, stock records and VAT calculations.

Capital Asset Scheme: revised definition

The definition of a capital asset is revised to refer to a business asset with a cost of AED 5 million or more, excluding VAT, on which VAT is payable.The existing useful life conditions remain at 10 years for a building or part of a building and five years for other capital assets.

The amendment does not change the AED 5 million threshold or the adjustment periods, but businesses should confirm that capital asset registers identify the cost excluding VAT, VAT payable, first use date and annual recovery position.

This is particularly relevant to real estate, energy, infrastructure, manufacturing and other capital intensive sectors. Projects involving staged payments or related construction, refurbishment or installation costs should continue to be assessed under the detailed aggregation rules in the Executive Regulation.

Other clarifications

For input VAT recovery linked to qualifying financial services supplied outside the UAE, a person will be treated as outside the State where its presence in the UAE is less than 30 days and that presence is not effectively connected with the supply. The amendment replaces the previous reference to a presence of less than one month with a specific 30 day period.

Taxpayers relying on this rule should ensure they retain sufficient evidence to demonstrate that the recipient's presence in the UAE did not exceed the 30 day threshold and was not effectively connected with the relevant supply.

The amendments also correct the required wording on a tax credit note so that the words “Tax Credit Note” must be clearly displayed. Businesses should confirm that credit note templates use the required wording.

Practical considerations

Although some amendments clarify existing rules, others may change current VAT recovery outcomes or require updates to contracts, policies, systems and calculations. Businesses should prioritise the areas that are relevant to their operations and retain a clear record of the review performed.

- Reassess bundled supplies and the identification of the principal component.
- Strengthen documentation for employee benefits and review the specific basis for accommodation recovery.
- Map material cash payments and prepare for the forthcoming threshold and controls.
- Model the new partial exemption formula using historic and forecast data.
- Update product coding, acquisition cost records, capital asset registers and tax credit note templates as required.

Businesses should assess which amendments are relevant to their operations ahead of 1 October 2026 and consider any required updates to contracts, policies, VAT processes, systems and supporting documentation. The revised apportionment rules should also be factored into future VAT compliance planning ahead of their effective date.

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