VAT brief | *Takaful*

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The Saudi VAT law has now been ratified. GAZT has released its calendar of VAT deadlines moving towards the 1 January implementation date. The Saudi implementing regulations have been finalised. The UAE has released its federal decree on VAT. Implementing regulations are expected imminently. Key decision makers should now be more aware than ever that we are entering into a new tax era. Businesses in the UAE and Saudi Arabia now have less than 75 working days to prepare for the implementation of VAT.

What is VAT?

- VAT is a tax on consumption, not income or profits.
- The GCC countries have agreed a standard VAT rate of five percent.
- Goods and services can be exempt, zero-rated or standard-rated (five percent).
- Registered suppliers will add VAT to the price of a good or service they supply, collect the tax and pay it to the tax authority on a regular basis.
- Registered businesses should (where the supplies they make are either standard or zero-rated) be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are exempt from VAT will not be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are zero-rated will usually be in a refundable position.

How will VAT affect the *takaful* sector?

- *Takaful* is generally based on forming a common pool of funds, making "conditional donations" – *tabarru* - and investing in *riba*-free instruments.
- From a VAT perspective, conventional insurance and *takaful* are treated the same.
- Saudi Arabia's implementing regulations state that general *takaful* will be standard rated, while family *takaful* plans are exempted from VAT.
- Output VAT on facultative reinsurance contracts and treaty contracts may differ.
- Fee-based services such as surrender, partial withdrawal or re-instatement fees, are standard rated.
- Reinsurance is a common practice in the *takaful* industry with *takaful* operators purchasing re*takaful* contracts. The applicable VAT rate may depend on the place of the underlying risk, the place of the *takaful* operator or the place of the *takaful* reinsurer.
- Output VAT on facultative reinsurance contracts and treaty contracts may differ.
- The apportionment of input tax credits may be required if general takaful has any investment elements (such as investment-type riders) as part of the policy.
- Exemptions increase costs for *takaful* operators as they will be unable to recover VAT paid on exempt supplies.
- *Takaful* operators will want to maximise the recovery of input tax credits, requiring them to carefully consider any purchases of goods and services and how best to minimise input VAT they cannot claim.
- *Takaful* operators may decide to increase the costs they charge their customers –but will need to be wary of regulatory constraints and the impact on their competitive advantage.
- Transitional issues will arise when *takaful* plans purchased or renewed before the VAT implementation date (1 January 2108 for Saudi Arabia and the UAE) if coverage periods straddle that date. *Takaful* operators may be required to charge VAT on the premium. If the *takaful* operator is unable to pass on the VAT liability to policyholders, this will reduce revenues.

What still needs to be clarified?

- Will there be any deemed input tax credit on cash settlements made by *takaful* operators for their business-to-customer insurance business?
- How will self-billing arrangements apply to reinsurance contracts?
- How will insurance contracts underwritten outside the country but provided locally (in other words, the insurance policy is supplied by an overseas insurer with a branch in the country) be taxed?

Important note

These briefs are based on a translation of Saudi Arabia's VAT legislation, the UAE federal law, the Saudi implementing regulations and general VAT principles and are provided for information purposes only. Saudi Arabia and the UAE continue – as of the date of release of this brief – to work towards an implementation date of 1 January 2018. This brief is not a substitute for professional advice. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.

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