VAT brief | Insurance

May 2018 | Kingdom of Bahrain

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Saudi Arabia and the UAE implemented VAT on 1 January 2018, with the other GCC countries expected to follow in the next 12 months. Business leaders should now be more aware than ever that we are entering into a new tax era. Key decision makers in the UAE and Saudi Arabia need to ensure their processes and systems are - and remain - VAT-compliant, while their counterparts in the other GCC states need to start preparing now 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.
- The supply of goods and services can be exempt, zero-rated or standard-rated (five percent), or out of scope.
- Registered businesses account for VAT on the price charged for the goods or services they supply 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 or out of scope with recovery) 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 cannot recover the VAT they have incurred in the course of making those supplies.
- Registered businesses may not be able to recover the VAT they have incurred on certain purchases that are deemed to have a private element.
- Registered businesses that make supplies that are predominantly zero-rated are likely to be in a VAT refund position.
- Businesses that make both exempt and taxable supplies can only recover a proportion of their input VAT.

How will VAT affect the insurance sector?

- General insurance protects assets and liabilities against loss or damage. General insurance products are standard-rated, while investment-type insurance products such as life insurance (including the reinsurance of a life insurance contract) is VAT-exempt.
- Fee-based services - such as management fees, commissions and advisory services - are standard-rated, even if the services are provided in relation to a VAT-exempt insurance product.
- Unless the VAT rules specify otherwise, the VAT treatment of the insurance or reinsurance premiums is likely to be determined - as in the UAE and Saudi Arabia - based on the location of the supplier and the customer – not necessarily based on where the risk or coverage is situated.
- In a typical reinsurance arrangement, there will be two types of considerations received by two different parties - the reinsurance premium (received by the reinsurer) and the commission (received by the insurer or cedant). Time of supply is complicated. Under a treaty arrangement, the value of the risks ceded by the reinsurer is usually only known on a quarterly basis - after the cedant has provided a statement of account. However, the cover would have begun before this.
- Insurance contracts with riders (such as a general insurance contract with a life rider) may have two different VAT treatments, which would require an apportionment of the premium.

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- Making exempt supplies will increase costs for insurers as they won't be able to recover the VAT incurred on related expenses.
- Insurers will need to carefully manage and oversee the claims process to ensure they are receiving valid tax invoices from their network providers to support any input tax deductions.
- Insurers may decide to increase their premiums in light of VAT – but will need to be wary of regulatory constraints and any impact this may have on their competitive advantage.
- Transitional issues - particularly on UPRs - will arise for insurance contracts purchased or renewed before the VAT implementation date if the coverage period straddles that date.
- Where insurers are required to account for VAT on insurance premiums, profits may be affected if they are unable to impose that VAT on top of the premiums charged to policyholders.

What should the insurance sector be doing now?

- Consider all supplies made and determine their VAT treatment.
- Review cost profiles to identify any irrecoverable VAT on costs.
- Engage with customers and review contractual terms to ensure businesses have the contractual right to charge any VAT amount in addition to the price.
- Evaluate premium pricing strategy from operational and regulatory standpoints.
- Examine any long-term contracts spanning the date of implementation and decide whether VAT can - or should - be charged to customers.
- Examine potential VAT exposure in relation to premiums paid or invoiced before the implementation date where coverage extends into the VAT live era.