VAT brief | *Takaful*

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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 *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 is standard-rated (5%), while family takaful plans are exempted from VAT.
- The VAT mechanics for facultative reinsurance contracts and treaty contracts may differ.
- Fee-based services such as surrender, partial withdrawal or re-instatement fees, are standard-rated (5%).
- Reinsurance is a common practice in the *takaful* industry with takaful operators purchasing re*takaful* contracts. Unless the VAT rules specify otherwise, the VAT treatment of *takaful* and re*takaful* premiums is likely to be determined - as in the UAE and Saudi Arabia - by the location of the supplier and the customer, not necessarily where the risk or coverage is situated.
- *Takaful* providers who make VAT-exempt supplies (such as providing family *takaful* products) can't recover the VAT incurred in making those exempt supplies. Providers are required to apportion recovery of VAT incurred on general business expenses (not directly attributable to selling taxable or exempt products).

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- The apportionment of premiums may be required for general *takaful* products that have investment elements (such as riders) as part of the policy.
- *Takaful* operators should carefully consider any purchases of goods and services and how best to maximise the incurred tax they can claim.
- *Takaful* operators need to have robust processes and procedures in place with their network providers and third-party claims administrators (if relevant), to ensure they are obtaining valid tax invoices to support any input tax deductions.
- *Takaful* operators may decide to pass on the cost impact of VAT when setting the pricing of their products, but need to be wary of any regulatory constraints and the impact this may have on their competitive advantage.
- Transitional issues arise for *takaful* plans which span VAT implementation, as the portion provided after the implementation date is likely to be subject to VAT.
- If a *takaful* operator is unable - or unwilling - to charge the VAT amount as an additional amount on top of the premium, total revenues will be reduced as the operator must account for VAT within the set premium price.
- Making exempt supplies increases costs for *takaful* operators as they can't recover the VAT incurred on related expenses.

Areas which require further consideration

- How will the registration status of a policyholder affect *takaful* plans?
- Do *takaful* operators wish to enter into self-billing arrangements with their brokers, easing the process of obtaining VAT-compliant invoices to support input tax deductions?
- 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?
- What needs to be done now with polices spanning VAT implementation?

Important note

These briefs are based on a translation of the GCC VAT Treaty, UAE and Saudi Arabia's VAT legislation, the relevant regulations and general VAT principles and are provided for information purposes only.

Saudi Arabia and the UAE implemented VAT on 1 January 2018 and the other GCC countries continue – as of the date of release of this brief – to work towards implementation in 2019.

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.