

VAT brief | *Takaful*

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Saudi Arabia and the UAE implemented VAT on 1 January 2018. Bahrain has confirmed implementation on 1 January 2019, with the other GCC countries expected to follow over the next 12 months. Business leaders should now be more aware than ever that we have entered a new tax era. Key decision makers in the UAE, Saudi Arabia and Bahrain 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.
- 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.
- The mandatory registration threshold is the equivalent of US\$100,000 - as set out in the GCC VAT treaty. The voluntary registration threshold is the equivalent of US\$50,000.
- 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 does 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. While the exemption on family *takaful* plans has been specifically provided in the Saudi and UAE VAT laws, Bahrain's VAT law is silent on this issue. Any deviation on the treatment of family *takaful* plans between GCC states may create further intricacies to *takaful* operators who operate in multiple GCC jurisdictions.
- 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 *retakaful* contracts. Unless the VAT rules specify otherwise, the VAT treatment of *takaful* and *retakaful* premiums is likely to be determined - as in the UAE, Saudi Arabia and Bahrain - by the location of the supplier and the customer, not necessarily where the risk or coverage is situated.



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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* 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).
- *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.

What should *takaful* providers be doing now?

- Consider how the registration status of a policyholder might affect *takaful* plans.
- Decide whether to enter into self-billing arrangements with their brokers, easing the process of obtaining VAT-compliant invoices to support input tax deductions.
- Investigate how self-billing arrangements applies to reinsurance contracts.
- Consider how *takaful* contracts underwritten outside the country but provided locally (in other words, the *takaful* policy is supplied by an overseas insurer with a branch in the country) are taxed.
- Consider how to treat policies spanning VAT implementation.

Important note

The information in this document is based on translations of the draft Bahrain VAT law, the VAT laws and regulations of the UAE and Saudi Arabia, the GCC VAT framework and general VAT principles. It is provided for information purposes only. As the draft Bahrain VAT law has been recently released and is still being reviewed in detail, any comments on this law are preliminary in nature and are likely to change. Any omissions or errors are inadvertent. This document should not be relied upon in making any decisions. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.