

VAT alert | NBR issues financial services VAT guide

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Bahrain's National Bureau for Revenue (NBR) has recently circulated welcome guidance in the form of a financial services VAT guide which sets out VAT principles specifically relevant to the financial services and insurance sectors.

Guidance and key clarifications

Financial services

- **Interest income on bank deposits** is generally out-of-scope.
- Interest income earned by **financial institutions** and by a **taxable person** who has actively sought to realise this income (for example, by negotiating special interest rates) is an exempt supply (unless zero-rating rules are met).
- The person bearing the cost of **money transfer** and **remittance services** may not necessarily be the recipient - the terms of any underlying agreement prevail in determining the real recipient.
- For **correspondent banking** services, resident banks must identify the recipient of their services (that is, whether the recipient is the foreign bank, the transferor or remitter or the beneficiary).
- Similarly, for **financial guarantee** and **security** transactions (such as letters of credit) involving multi-party arrangements, the actual recipient of the service (not the beneficiary or paying party) must be identified.
- With card transactions, the recipient of **interchange services** provided by an issuer is the **acquirer**, even though the card scheme operator acts as a medium between issuers and acquirers.
- Input VAT related to payments to **card network operators** (resident in or outside Bahrain) can be recovered if used by members to make taxable supplies (such as membership or assessment fees paid to network operators).
- **Site ATM rental services** follow real estate place of supply rules as they are land-related services. In Bahrain, these supplies are therefore usually exempt from VAT.
- While financial institutions often amortise **financing fee income** in their books, such accounting treatment does not, in itself, substantiate whether the underlying services are one-off or continuous supplies for VAT purposes.
- **Granting of collateral** for securing loans is disregarded for VAT purposes.
- With loan syndication arrangements, lead banks (usually operating as disclosed agents) are providing **syndicate administration** and **management services** to syndicate members, which are therefore taxable.
- With **asset financing transactions** (where there is an asset transfer), VAT becomes due at the earlier of the asset being placed at the purchaser's disposal (unless a tax invoice is issued or payment is received earlier), irrespective of whether legal ownership is transferred at that point.
- Irrecoverable output tax resulting from **repossession of financed assets** by banks or financial institutions is eligible for bad debt relief.
- Where an **intermediary's services** have been sought on a retainer basis (to broker a financial arrangement or credit finance transaction), these may be seen as continuous supplies of services, depending on the terms of the underlying agreement.

- A **local sale** of a **debt** is exempt from VAT while an **assignment** of a **debt** is out of scope.
- While a **local sale** of **equity** and **debt securities** or the **lending** of **securities** are VAT-exempt, the **issue** of equity and debt securities is outside the scope of VAT.
- The consideration for the local supply of a **financial derivatives** contract is the profit margin realised by the seller of the contract (during settlement, exercise, expiry or termination) and is exempt for VAT purposes.
- From a VAT perspective, an investment fund (under a **collective investment scheme**) is considered as a separate person from its unit holders and so may be required to be separately registered for VAT - if the fund is not a legal entity, the fund operator has to segregate its business to report the fund's activities separately.
- When determining the appropriate VAT treatment of **Islamic finance products**, it is important to analyse their underlying **purpose, features** and **circumstances**, even though conventional and Islamic finance products which are similar in terms of intended objectives and which materially achieve the same results, are supposed to have similar VAT treatments.

Insurance

- **Life insurance** and **life reinsurance** contracts (defined in the guide) are VAT-exempt financial services in Bahrain (unless the zero-rated rules are met).
- **Islamic life insurance** contracts (*takaful*) are generally exempt from VAT (unless the zero-rating rules apply) like their conventional life insurance equivalents.
- Other types of insurance and reinsurance contracts are subject to VAT at the standard rate (or at the zero-rate in certain circumstances).
- The zero-rating on insurance contracts relating to the **international transportation** of goods and passengers has been extended to also include reinsurance contracts.
- **Cash settlements** and **financial indemnities** are not considered as a consideration for any supply and so are out of scope of VAT.
- The replacement of goods or services provided by a third party is a supply provided to the **insured** and not to the **insurer** (although the insurer could be viewed as 'assuming' the risk of the insured) – meaning third-party suppliers or service providers should only bill the insured with any VAT charged by the third party service provider unclaimable by the insurer.

- From a commercial perspective, the insurer may **choose** to pay an indemnity **exclusive** of VAT (since VAT is incurred by the insured and the insured will be eligible to claim if s/he is registered) or to pay an indemnity **including** VAT – although this could drive up prices.
- Where **replaced goods** are provided to the insurer, the insurer should not claim any VAT charged – if VAT has been charged on replacement and recovered by the insurer, it must be accounted for by the insurer based on the cost price of the goods when handed to the insured (and is viewed as a form of deemed supply).
- The recovery of claims from a third party insurer under knock-for-knock arrangements is not a consideration for a supply - and so out of scope for VAT.
- The NBR has decided that brokers are providing brokerage services to the **insured** under **direct insurance arrangements** and to **insurers** under **reinsurance arrangements**:
 - For accounting purposes, **insurers** must ascertain the location of the **insured** and the **reinsurer** to determine the **cedant's** location and identify the VAT treatment of brokerage services.
 - Services received from brokers outside Bahrain are subject to the **reverse charge mechanism**, either by the **insured** (under a direct insurance arrangement) or the **cedant** (under a reinsurance arrangement).
- Brokers must issue tax invoices on brokerage services to the **insured** or the **cedant**, depending on the arrangement, and disclose commission earned to the **insured** (under a direct insurance arrangement) or **insurer** (under a reinsurance arrangement), which may conflict with current business practice.
- With brokers providing services to the **insured** but billing the **insurer** under a direct insurance arrangement or providing services to the **cedant** but billing the **reinsurer** under a reinsurance arrangement, **self-billing arrangements** are not feasible.
- Generally, brokerage is seen as a **one-off supply** and so VAT should not impact brokerage services relating to insurance contracts straddling VAT's implementation date if a brokerage service was completed prior to implementation.
- Unlike an insurance broker, an insurance agent provides agency services to the policy issuer - that is, to an **insurer** under a direct insurance arrangement and to a **reinsurer** under a reinsurance arrangement.
- **Self-billing arrangements** may be entered into by an insurance agent with the **insurer** - for direct insurance arrangements - or with the **reinsurer** - for reinsurance arrangements - on the basis that the recipient of the service and the billing party are the same person.



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- Generally, an **agency service** is a **continuous** supply, necessitating VAT on insurance agency services for contracts straddling the VAT implementation date and with tax due dates subject to the general time of supply rules for continuous supplies.

Apportionment ratios

- **Net foreign exchange gains and losses** realised during a tax period - as well as margins realised on the sale of securities, derivatives and script-lending arrangements - should be included in the denominator which may require a **special apportionment method** to distinguish between zero-rated and exempt gains and margins.
- In **asset finance arrangements**, the sale of assets - as with sales of **debts without recourse** - should not be included in the ratio as inclusion may distort input tax recovery positions.
- When using the **standard apportionment method**, only interest income and fees for services associated with **granting financing** can be included when calculating ratios so FIs may wish to consider applying for a special method to include only the **net interest income**.
- The issue of **equity and debt securities** on a primary market either publicly (IPO) or through private placement is outside the scope of VAT and should therefore not be included in the ratio.

Important note

The information in this document is based on translations of the VAT legislation of the UAE, Bahrain and Saudi Arabia, the GCC VAT framework and general VAT principles. It is provided for information purposes only. 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.

- VAT incurred on costs relating to the issue of securities should be treated as **business overhead costs** if incurred to fund the issuer's overall business activities and so may be recovered.
- When calculating the ratio, the tax year is 1 January to 31 December.
- Input tax incurred in year 1 but recovered in year 2 (perhaps because of an invalid tax invoice) should be apportioned in accordance with year 1's apportionment ratio.

Invoicing and other points

- Information to be included in **tax invoices, summary tax invoices, bank statements** in lieu of tax invoices, **self-issued tax invoices** and **invoices under the reverse charge mechanism** has been specified.
- Tax invoices do not have to be issued for **VAT-exempt financial services** remunerated by way of interest or a margin but should be issued for other VAT-exempt financial services such as the provision of life insurance.
- '**Punitive**' charges (treated as out of scope) will be determined on a case-by-case basis as the **terms of payment** and whether the penalty is viewed as **consideration for a supply** must be assessed.
- Where the VAT amount due on a tax invoice is a fraction of a fils, the value can be rounded to the nearest fils based on **mathematical rounding rules**.