VAT brief | Insurance

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We have entered a new tax era. Saudi Arabia and the UAE implemented VAT on 1 January 2018. Bahrain implemented - for businesses with taxable turnovers above BD5m - on 1 January 2019 - with other businesses going live on 1 July 2019 or 1 January 2020. Other GCC countries are expected to follow. Key decision makers in the UAE, Saudi Arabia and Bahrain need to ensure their processes and systems are - and remain - VAT-compliant, while their peers in other GCC states need to start preparing now for VAT's implementation.

What is VAT?

- The GCC countries have agreed a standard VAT rate of five percent.
- Supplies of goods and services can be exempt, zero-rated or standard-rated (five percent), or out of scope.
- The mandatory registration threshold (MRT) is the equivalent of US$100,000. The voluntary registration threshold is the equivalent of US$50,000. Bahrain has staggered VAT's introduction.
- Registered businesses account for VAT - a consumption tax - on the price charged for the goods or services they supply and regularly pay the VAT to the tax authority.
- Where registered businesses make supplies that are standard- or zero-rated or out of scope with recovery, they should be able to recover the VAT they have incurred in making those supplies.
- Registered businesses making supplies that are exempt from VAT cannot recover the VAT they have incurred in the course of making those supplies.
- Registered businesses may be unable to recover VAT incurred on purchases that are deemed to have a private element.
- Registered businesses making 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 businesses in the insurance sector?

- General insurance – which is standard-rated - protects assets and liabilities against loss or damage.
- Investment-type insurance products such as life insurance (including the reinsurance of a life insurance contract) are 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, Saudi Arabia and Bahrain – by the location of the supplier and the customer – not necessarily where the risk or coverage is situated.
- In a typical reinsurance arrangement, two types of considerations are received by two different parties – a reinsurance premium (received by the reinsurer) and a 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 begins before this.

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- Insurance contracts with riders (such as a general insurance contract with a life rider) may have two different VAT treatments, requiring an apportionment of the premium.
- Making exempt supplies increases costs for insurers as they can't recover the VAT incurred on related expenses.
- Insurers 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 need to be wary of regulatory constraints and any impact this may have on their competitive advantage.
- Transitional issues - particularly on UPRs - arise for insurance contracts purchased or renewed before the VAT implementation date if the coverage period straddles that date. This has proved troublesome.
- 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 businesses in 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 strategies 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.