VAT brief | *Takaful*

January 2018 | Manama | Kingdom of Bahrain

keypoint

Saudi Arabia and the UAE implemented VAT on 1 January 2018, with the other GCC countries expected to follow in the next 12 months. Key decision makers should now be more aware than ever that we are entering into a new tax era. Key decision makers at businesses in the UAE and Saudi Arabia need to ensure their processes and systems are 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.
- Goods and services can be exempt, zero-rated, standard-rated, or out of scope.
- Registered suppliers will need to account for VAT out of 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) 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 will not be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are zero-rated will usually be in a refundable position.

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 will be standard rated, while family takaful plans are exempted from VAT.
- Output VAT on facultative reinsurance contracts and treaty contracts may differ.
- Fee-based services, such as surrender, partial withdrawal or re-instatement fees, are standard- rated.
- Reinsurance is a common practice in the takaful industry with takaful operators purchasing retakaful contracts. The applicable VAT rate may depend on the place of the underlying risk, the place of the takaful operator or the place of the takaful reinsurer.
- Input tax deductions may need to be apportioned if general takaful includes investment elements (such as investment-type riders).
- Exemptions increase costs for *takaful* operators as VAT paid on exempt supplies cannot be recovered.
- *Takaful* operators will want to maximise the recovery of input tax credits, requiring them to carefully consider any purchases of goods and services and how best to minimise input VAT they cannot claim.
- *Takaful* operators may decide to increase the costs they charge their customers – but will need to be wary of regulatory constraints and the impact on their competitive advantage.
- The portion of a *takaful* plan which spans the VAT implementation date is likely to be subject to VAT. If the *takaful* operator is unable to charge VAT on top of the premium, total operator revenues will be reduced.

Areas which need further consideration

- Will the VAT rules contain deemed input tax credit provisions on cash settlements made by *takaful* operators for their business-to-customer insurance businesses?
- 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?

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Important note

These briefs are based on a translation of the 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 the next 12 months. 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.

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