VAT brief | *Takaful*

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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 *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.
- 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, Saudi Arabia and Bahrain - by the location of the supplier and the customer, not necessarily where the risk or coverage is situated.
- 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).


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- *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 where recovery is allowed.
- *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 businesses in the *takaful* sector 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 polices spanning VAT implementation.