

VAT

Consideration for Actuaries



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Presentation Summary

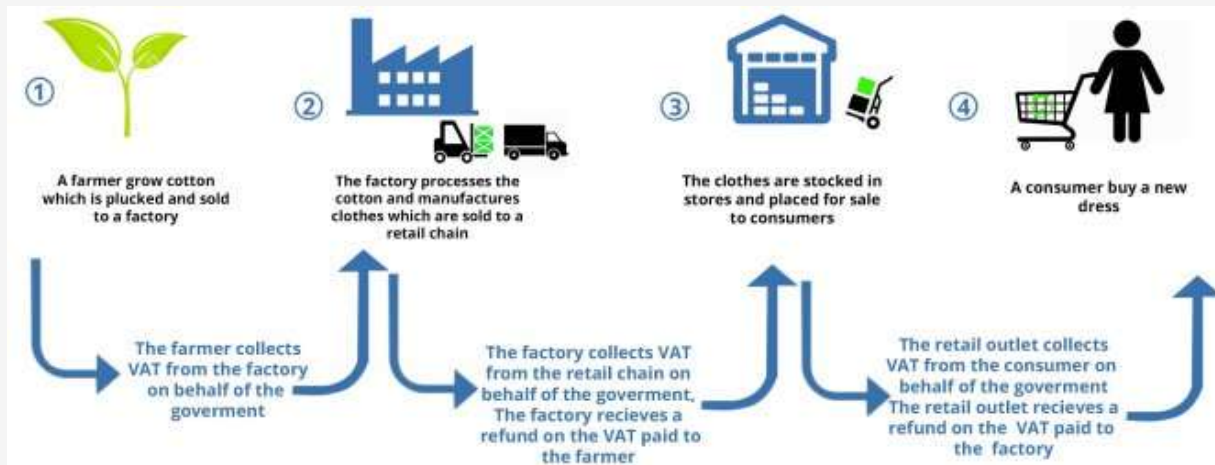
- Industry Update (Q3 Results)
- Understand VAT
- VAT for Insurance Sector
- VAT for Actuaries
- Q and A

Industry Update

All figures in AED Millions	Gross Premium		Net Technical Profit		Investment Income		Net Profit	
	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016	Q3 2017	Q3 2016
ADNIC	1,983	1,763	91	72	88	72	179	144
ADNTC	301	279	37	35	10	10	47	45
Al Ain Ahlia	1,129	741	26	27	17	29	43	56
Al Buhaira	428	615	13	14	29	32	42	46
Al Dhafra	332	271	19	3	20	24	39	27
Al Fujaira	175	159	17	4	5	8	22	12
Al Sagr	315	304	20	7	(3)	24	17	31
Al Wathba	184	243	19	(12)	40	68	59	56
Alliance	212	234	(6)	(10)	43	43	37	33
AMAN	247	280	(12)	(22)	16	21	4	(1)
ASCANA	190	126	(9)	(8)	19	24	10	16
Dar Al Takaful	313	205	3	(2)	4	3	7	1
Dubai Ins	399	342	14	15	15	19	29	34
Dubai National Ins	258	211	17	14	25	28	42	42
Emirates Insurance	895	847	35	17	48	49	83	66
Green Cres	33	39	(24)	(16)	3	3	(21)	(13)
Insurance House	181	129	2	(12)	2	6	4	(6)
Methaq	299	185	2	(6)	-	1	2	(5)
NGI	454	424	15	5	11	16	26	21
Oman	2,873	2,779	24	22	57	57	81	79
Orient	2,915	2,085	183	137	122	125	305	262
Orient UNB Takaful	8	-	(3)	-	2	-	(1)	-
RAK	356	322	12	(3)	6	11	18	8
Salama	601	595	7	(219)	14	(8)	21	(227)
Sharjah	47	54	9	(6)	13	10	22	4
Takaful EM	478	437	2	(7)	(1)	18	1	11
UNION	802	659	15	16	(9)	(29)	6	(13)
United	62	54	(8)	(11)	3	5	(5)	(6)
Watania	194	150	1	(8)	5	7	6	(1)
Total	16,664	14,532	521	46	604	676	1,125	722

Understanding VAT

VAT explained



	Sales	5% VAT charged on Sales	VAT recovered on purchases	Net VAT payable
Farmer	AED 1,000	AED 50	AED 0	AED 50
Factory	AED 3,000	AED 150	AED 50	AED 100
Retailer	AED 5,000	AED 250	AED 150	AED 100
Total VAT paid by final consumer;				AED 250

Net result = VAT is collected through the chain and the end -consumer bears the cost

Output and Input Tax



Output Tax

	Sales	5% VAT charged on Sales	VAT recovered on purchases	Net VAT payable
Farmer	AED 1,000	AED 50	AED 0	AED 50
Factory	AED 3,000	AED 150	AED 50	AED 100
Retailer	AED 5,000	AED 250	AED 150	AED 100
Total VAT paid by final consumer;				AED 250

Input Tax

Net result = VAT is collected through the chain and the end -consumer bears the cost

VAT Liabile, Exempt and Zero Rated

	VAT - Liabile	Exempt	Zero Rated
Output Tax	Subject to 5% VAT (for VAT liabile transaction)	Cannot Charge VAT to the customers	Sales to Zero rated entities are subject to 0% VAT
Input Tax	Allowed to claim input tax of 5% on VAT purchases of Goods and Services	Not Allowed to Claim Input Tax	Allowed to Claim Input Tax. VAT paid on Goods and service becomes an Asset.

Retailer is Zero Rated



	Sales	5% VAT charged on Sales	VAT recovered on purchases	Net VAT payable
Farmer	AED 1,000	AED 50	AED 0	AED 50
Factory	AED 3,000	AED 150	AED 50	AED 100
Retailer	AED 5,000	AED 0	AED 150	AED - 150
Total VAT paid by final consumer;				AED 0

Net result = VAT is collected through the chain and the end -consumer bears the cost

Retailer is Exempt



	Sales	5% VAT charged on Sales	VAT recovered on purchases	Net VAT payable
Farmer	AED 1,000	AED 50	AED 0	AED 50
Factory	AED 3,000	AED 150	AED 50	AED 100
Retailer	AED 5,000	AED 0	AED 150	AED 0
Total VAT paid by final consumer;				AED 150

To be charged by changing the price and not explicitly

Net result = VAT is collected through the chain and the end -consumer bears the cost

VAT for Insurance

Insurance sector - VAT

- The insurance industry is a very complex business from a VAT perspective, and negotiations in relation to VAT between the insurance regulator, Ministry of Finance and insurers are often protracted. In Singapore for example, negotiations between the various participants and the IRAS (National Tax Authority) were not resolved until shortly before the tax was introduced.
- Life insurance is often conceptually considered to be an investment product rather than a risk-based product, leading to life policies being exempt from a VAT in many jurisdictions (including UAE).
- Islamic insurance companies providing Takaful and other insurance products have different treatments in order to be Shariah compliant, but in essence, the VAT treatment in the UAE will treat both in the same way.

VAT Liable, Exempt and Zero Rated – Insurance Products

VAT - Liable

In various VAT briefings conducted by UAE Ministry of Finance (MOF), it was mentioned that the provision of most local insurance products will be subject to the standard VAT rate of 5%

Exempt

Life Insurance is an exception and would be VAT exempt.

Zero Rated

Certain insurance products of an international nature will be subject to a zero rate of VAT. Examples, Travel, Marine (Hull, Aviation, Cargo). Currently, the UAE VAT law does not clearly zero rate the products mentioned above.

Transactional Provision and Contracts

- For policies spanning across the implementation date, any supply made after the introduction of VAT will fall under the tax net and hence subject to VAT.
- It is suggested that the policies should either be revised or addendums be issued to ensure that VAT can be charged to the customers and does not become a cost to the company
- As per the technical sessions conducted by Ministry of Finance, it appears that where the customer would be entitled to full input tax, the law will introduce provisions to allow the supplier to charge VAT even in the absence of a VAT clause. Where the customer would not be entitled to full input tax and the negotiations to pass on the VAT burden fails, the tax will become a cost to the company.

How VAT will impact everything from auto insurance to cleaning contracts

Failure to update contracts could result in companies being liable for taxes

Published: 20:37 November 21, 2017
Ed Clowes, Staff Reporter

GULF NEWS 
Gulf News

Gulf News has heard from some consumers after they received letters asking for more money for service contracts that extends into 2018. This includes auto insurance, commercial rental agreements and contracted services.

The reason is that these services will be taxable at a rate of five per cent under the value added tax (VAT) that will be introduced throughout the UAE on January 1, 2018.

Companies too are confused about how this will impact their service agreements, and lawyers that Gulf News spoke to say many are struggling to figure out just how to recover tax from customers, especially those who have paid for their services in advance.

Legal experts say that companies that provide taxable services must check their contracts to ensure that they include provisions for collecting taxes under the new regime. If they don't, they could be totally liable for the tax.

A silent contract means that it makes no mention of VAT.

"If the contract is silent ... then contractually he can't pass it on," said Shiraz Khan, a senior tax adviser at Al Tamimi & Company.

Other Definition

- **Grandfather Clause**

- A grandfather clause is an exemption that allows persons or entities to continue with activities or operations that were approved before the implementation of new rules, regulations or laws. In Saudi Arabia, for instance, there is a grandfathering clause, but in UAE does not mention any grandfathering arrangement.

- **Reverse Charging**

- Reverse Charge Mechanism is applicable while importing goods or services from outside UAE. Under this, the businesses will not have to pay VAT at the point of import physically.
- Reverse Charge Mechanism eliminates the obligation for the overseas seller to register for VAT in UAE.

VAT on Commission, Brokerage, and Reinsurance Premium

- Standard VAT rate would apply on the amount of commission and brokerage.
- For Reinsurance Premium, a reverse charging mechanism would apply. This essentially means that the company has to see 'what if' the re-insurer is in UAE.

VAT on Claims

- Insurance companies can claim the amount of VAT as input tax, if the 'invoice' is in the name of 'insurance company'.
- It is not clear, however quite likely, that the insured who have used third-party repairer (for example), 'the insurance company' may recover the VAT charged to the insurer.
- However, if the claim has been made as lump-sum settlement, the insurance company will not be able to claim VAT on the amount.

VAT for Actuaries

VAT consideration in Reserving
VAT in Pricing
VAT in Life Insurance

Adjustment of VAT in Unearned Premium Reserve

- VAT cannot be included as part of the premium and hence **no explicit provision** for VAT is required in UPR.
- During the transition period, Insurance companies may have to pay a huge amount of VAT on unearned premium reserves.
- Insurance companies may recover the same amount from corporate customers (as this will become their input tax) but it may be difficult to recover from individual customer.
- Subject to regulation, the 'additional' VAT payment (on 1st January 2018) can be adjusted as part of Deferred Acquisition Cost.
- However, this will be eventually nullified by the end of the year.
- Experts have also confirmed that there will be no impact in Technical Reserves on VAT

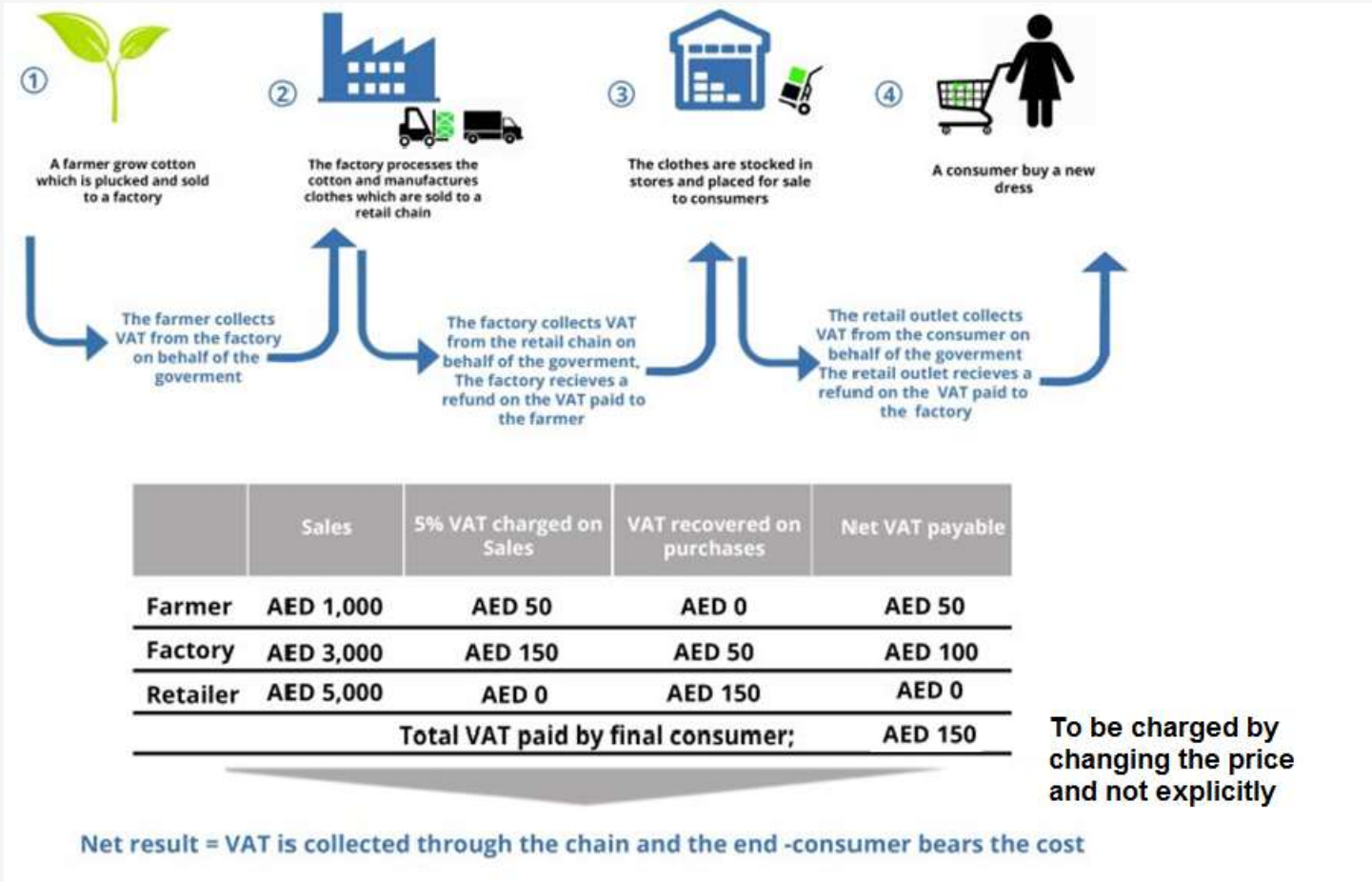
VAT in Pricing – Sum Insured

- Before moving to pricing, it is important to consider that should Sum insured should include or not include VAT.
- Suppose, that the car factory price is AED 100,000 and AED 5,000 VAT invoice is raised together with the car factory price.
- Should the sum insured be AED 105,000 or AED 100,000?
 - Customer(s) who are not VAT registered or VAT exempt should not increase the Sum Insured.
 - Customer(s) who are VAT registered or VAT free should not increase the Sum Insured

Impact on Premium with Change in Sum Insured

Itemwise Break-up Amounts in AED	Before VAT	Same Sum Insured			Increased Sum Insured		
		Cost	VAT Output	VAT Input	Cost	VAT Output	VAT Input
Total Loss	1,000	1,000	NA	0	1,050	NA	0
Partial Losses	2,000	2,000	NA	100	2,000	NA	100
Brokerage	500	500	NA	25	500	NA	25
Expense	750	750	NA	0	750	NA	0
Profit	750	750	NA	0	750	NA	0
Total	5,000	5,000	250	125	5,050	252.5	125
Rate with Sum Insured AED 100,000	5.00%	5.00%			5.05%		
Rate with Sum Insured AED 105,000	NA	NA			4.81%		

Life Insurance is an Exempt Supply of Insurance



Life Insurance

- Life Insurance is an exempt supply which means that you cannot charge VAT and you can neither claim VAT
- VAT for Banks and Brokers
 - Banks or Broker charging anything like a small %age of amount invested (like Fund Management Fee, acceptance of deposits, provision of loan, etc.) is VAT exempt whereas all the dollar amount is Vatable (e.g., cheque issuance fee, annual statement fee, etc.) is subject to VAT
 - The commission collected by banks or brokers as an intermediary, irrespective life or non-life, is subject to standard VAT rate.

Life Insurance Irrecoverable VAT

- The irrecoverable VAT may constitute an important cost for life insurance and potentially impact their pricing policy. An early assessment of the VAT cost and impact to the bottom-line is required to ensure that prices and margins are rebalanced in time for 1 January 2018 to maintain current levels of profitability.
- This means that VAT incurred on common costs and general overheads (such as marketing and promotional expenses, utilities, professional fees, purchases of office furniture) – and lastly the most important one ‘**commissions**’ will not be claimable and would need to be apportioned.

Life Insurance VAT

- Under ideal circumstances, the additional VAT on Brokerage or Commission should be charged to the customers.
- However, the moment the VAT is disclosed to the customer, this implies that the commission is disclosed and hence it would be difficult to sell
- Predatory banks are demanding that they should be provided with an extra margin for VAT so that this should not be disclosed to the customers whereas the bank margins remain the same
- If an insurance company will not be able to bargain this cost, it has to be borne by the company

Life Insurance VAT

- Treatment for Riders
 - As per VAT executive regulation, “life insurance contract” means a contract lawfully entered into to the extent that it places a sum or sums at risk upon contingency of the termination or continuance of human life, marriage, similar relationships permitted under applicable law or birth of child”
 - It is not clear that riders should be treated as health (general) insurance or life insurance... Most likely to be treated as non-life product

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- Policy Admin Fee

- Policy Admin Fee usually charge in USD or AED per month may be also subject to VAT due to fixed amount

Life Insurance VAT

- Treatment for Riders and Policy Admin Fee
 - “single composite supply” means a supply of Goods or Services, where there is more than one component to the supply, and taking into account the contract and the wider circumstance of the supply
 - A single composite supply may exist under if all of the following conditions are met:
 - a. The price of the different components of the supply is not separately identified or charged by the supplier.
 - b. All components of the supply are supplied by a single supplier;

Life Insurance Profit Margin

- Most (not all) of the life insurance companies targets a profit margin of **5%** as **Present Value of Profit / Present Value of Premium**
- The Present Value Profit measure which is **Present Value Profit/ Premium** achieved is around **20%-30%**
- Assuming commissions around 100% of First Year Premium, the greedy intermediaries are asking for 5% more commission to account for extra VAT.
- Life insurance profitability is expected to decrease by 25% to 30%.

Spot the Difference



Answer: Regulation

Basic



Luxury

In UK, gingerbread man with more than 2 dots for eyes would be at least 20% more expensive due to VAT

Here's the official one [from HMRC \(UK VAT regulator\)](#): standard-rate VAT applies to “Gingerbread men decorated with chocolate unless this amounts to no more than a couple of dots for eyes”.

Question and Answers