

Bahrain VAT | Medical cover provided by insurance companies to their employees

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Background

VAT impacts different economic sectors in different ways. VAT for the insurance sector can be complex and challenging. In this edition of our Tax Insights, our Financial Services – Insurance – VAT specialists consider the complexities around the VAT treatment of medical cover provided by insurance companies in Bahrain to their employees.

Supply of goods and services to an employee by an employer has always been scrutinized by tax authorities internationally. Although, employment income in respect of services provided by an employee to an employer is outside the scope of VAT, there can be uncertainties where the supply is made by the employer to the employee.

The Bahrain VAT law has a specific “related party” provision governing the “employer-employee” relationship. Under an employment contract in Bahrain and the region, it is common for the employer to provide various ‘benefits-in-kind’ to their employees in addition to monetary compensation. One such benefit is the medical insurance cover provided by insurance companies to their employees. Generally, insurance companies self-issue medical insurance policies to their employees without having to obtain them from an external insurance company. In this case, the premium associated with the policies becomes part of the production register of the insurance company in the applicable tax period. Insurance companies may either issue the policies in their names (employer’s name) or in the name of the employee.

VAT implications

VAT only comes into play when there is a supply involved. In order to qualify as a supply, there must be an exchange of goods or services between two parties for consideration. If there is no consideration, the transaction can still qualify as a supply if it is deemed to be a supply under Article 10 of the Bahrain VAT Law. Further, the Bahrain VAT Law restricts companies from recovering input VAT on goods and services used by employees free of charge and for their personal use – unless it is mandatory to provide such goods or services to employees under applicable laws in Bahrain.

This leads to the following questions:

- ✓ Does the provision of employee medical cover qualify as a supply?
- ✓ If not, does it qualify as a deemed supply?
- ✓ Do insurance companies have to restrict the input tax recovery on employee policies?

It may be argued that since the medical insurance cover is one of the many benefits which the employer is providing to the employee under the employment contract, it should not qualify as a supply or for that matter a deemed supply.

However, since the service provided is used by employees predominantly for their personal use especially where the cover also includes their dependents or that the cover is beyond what is mandatorily required by applicable laws in Bahrain, a proportion of the input tax credit may not be recoverable.

A question that arises is how should insurance companies calculate the proportionate input tax credit for such policies in the absence of any prescribed procedures in the Bahrain VAT law. Would it be acceptable for the insurance company (employer) to block a portion of the common input tax credit up to the extent of the fair market value of such policies? Is there room for interpretation on the calculation of the common inputs?

Should the provision of free medical cover be treated as a supply chargeable at 5% based on the fair market value of such policies (even if it means insurance companies are to bill themselves) or should insurance companies be required to reverse the proportionate common input tax credit. Considering that it has been less than 2 years since the introduction of VAT in Bahrain VAT, any position taken on this is yet to be tested.

Other considerations

Given the ambiguities regarding the VAT implications on the provision of free medical cover by insurance companies to their staff, other considerations include:

- ✓ On the basis that input VAT incurred on medical insurance policies provided to an employee is recoverable by a taxable person, can it be argued that there is no deemed supply if the medical insurance policy is provided internally by an insurance company?
- ✓ Can it be argued that there should be no requirement for specific attribution of costs associated with employee medical insurance policies on the basis they are recoverable anyway if mandatorily required by the applicable laws in Bahrain?

Providing a cash allowance to employees and requiring them to arrange for medical insurance themselves would not have any tax implications on the insurance company as this will be outside the scope of Bahrain VAT.

Next steps

All insurance companies should examine such transactions to determine any possible VAT implications and whether any previously filed VAT returns may require rectification. A cost benefit analysis should also be carried out to determine the difference between the input tax credit which can be foregone as against the standard rate of VAT on the fair market value of such policies.

This document is for general information only and is not intended to address the circumstances of any particular scenario. Please seek professional advice in relation to your particular circumstances.

Contact us:

**Philippe Norré**

Partner, Head of Tax &
Corporate Services
T: +973 17201400
E: pnorre@kpmg.com

**Mubeen Khadir**

Partner
T: +973 17201454
E: mubeenkhadir@kpmg.com

**Ali AlMahroos**

Director
T: +973 17201459
E: aalmahroos@kpmg.com

**Adria Campbell**

Senior Manager
T: +973 17201403
E: abugeac@kpmg.com

**Omar Hisham**

Senior Manager
T: +973 17224807
E: sosaid@kpmg.com

**Shashank Chandak**

Manager
T: +973 17201462
E: shashankchandak@kpmg.com

**Hasan Khalaf**

Manager
T: +973 17222301
E: hakhalaf@kpmg.com

**Mansoor Al Wadaie**

Manager
T: +973 17224807
E: malwedaie@kpmg.com

**Nik Faiziman Affandi**

Manager
T: +973 17201457
E: naffandi@kpmg.com

<https://home.kpmg/bh>

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