

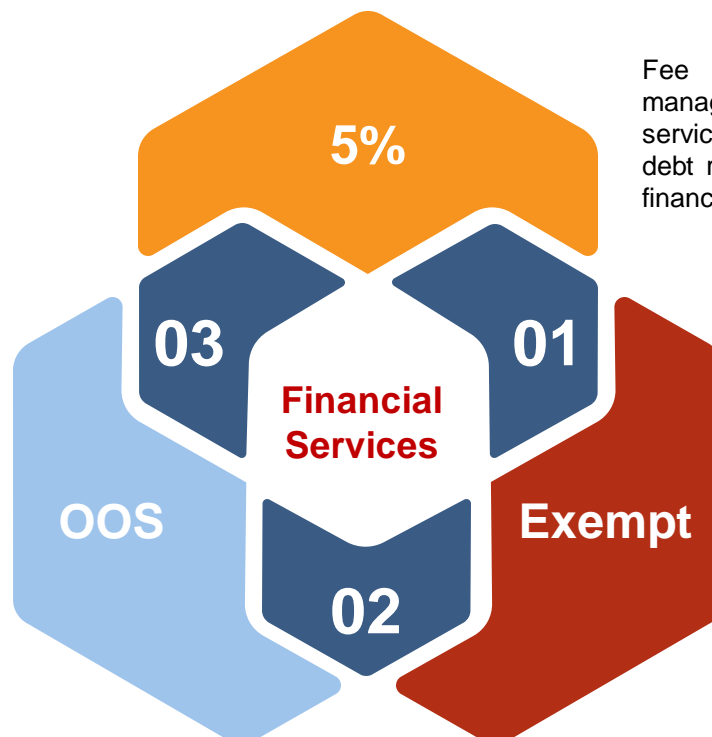


Financial Services Guide

Introduction

The Federal Tax Authority (FTA) has recently issued Financial Services VAT Guide (VATGFS1) with list of services and functions carried by Financial Service Providers and application of VAT on the same. In this alert, we are pleased to summarise the FTA Guide as under:

VAT Impact on Financial Services



Fee based services, portfolio management services, trustee services, intermediation services, debt recovery and litigation, leasing, finance charges etc.

Return on investment, pension or collective investment scheme, issuance / redemption of loyalty points, cash rebate, disbursements, dividends etc.

Interest, Interest rate swaps, currency swaps, net margin or swaps, trading income, supply of credit etc.

*OOS – Out of Scope

Retail & Private Banking

5%

Fees for opening, maintaining, closing accounts, withdrawals, deposits, etc.

Early Redemption Fee

Transaction services fee

Minimum balance fee

Overdraft fees

Dormant / inactivity account service charges

Fees for cheques, including issuance, cancellations, guarantees, copies, service charges, re-presenting dishonoured cheques, etc

Certificate / letter issuance fees

Bank statement fees

Fees for traveller's cheques, foreign currency

Money transfer fees, including processing overdue payments

Fees for safe custody of cash

Direct debit / standing order fees, including re-presenting dishonoured amounts, etc.

Credit card membership fees, service charges, late payment fees, cash advance fees, over the limit fees, etc.

Minimum spend fee

Cash back / profit sharing arrangement with selected Merchants

Fee and charges received by card brand companies

Debit cards - all related fees

Loan, mortgage and other credit facilities – all opening fees, processing fees, late payment fees, etc.

Recovery of non-performing loans - all related fees

Hire purchase

Promissory notes

Gold loans - transaction fees for gold certificates

Foreign Exchange (FX) – sales and purchase fees

Company name change fees

SMS services fee

Settlement fees between banks

Correspondent Bank services (taxable unless merely a pass through)

Exempt

Overdraft interest income

Interest income earned on credit cards

Finance charge (Interest)

Dynamic currency conversion (forms part of the foreign exchange spread and implicit in nature)

Foreign exchange spreads earned on credit cards

Delayed payment penal interest charges

Gold loans (lending interest)

FX realized profits and loss spot/translation (spread income)

Retail & Private Banking

Contd.

OOS

Waiver of fee / services provided for free to all / or specific banking Customers

Issuance of loyalty points for use of card (provided consideration does not exceed advertised value)

Redemption of loyalty points for use of card

Cash rebate (award to customers)

Disbursements, e.g. collection of legal fees; cost recoveries (repossession, irrecoverable tracing fee, auctioneer's commission, storage fees, towing fees, legal fees); sales agent fees etc.

Asset Management and Private Banking

5%

Management fees, sales fees, distribution fees, performance fees, etc.

Revenue sharing arrangements - revenue share between Asset Management company and Private Banking Business Unit (if different entities)

Revenue share with third party companies on account of performance fee earned on funds

Retrocessions / Rebates - commissions received from fund houses for routing customers for wealth-related transactions

Custody and Securities Services, Trustees Services

Commissions for switching, transfers, incentive fees, etc.

Exempt

Investment income – interest income

OOS

Recharge income (e.g. recharges of expenses paid on behalf of underlying funds managed) – Disbursement

Initial investment by fund manager

Equity Trading

5%

Transaction fee income (Direct Fixed Income/Equities/FX)

Brokerage fees charged to customers

Custody, processing fees etc.

Option Premiums

Arrangement fees, rollover fees

Upfront fees - premium for structured products

Early Redemption fee

Collection Fee in respect of Dividends, Interest, Coupons

Securities Lending fee

Advisory services, e.g. retainer, milestone and success fees

Clearing fees

Minimum Monthly Fees

Exempt

Interest received on fixed deposit placed with other banks

Interest charged to or earned from customers on facility granted for margin trading

Manufactured interest

OOS

Dividends received on investments

Operational Losses borne by the business and not recharged to the customer

Initial/variation margin – futures

Manufactured dividend

Transaction Banking

5%

Trade finance fees

Letter of Credit fees

Guarantee services fees

Corporate lending - all fees e.g. settlement, termination, upfront fees, etc. except interest / profit which is akin to interest in Islamic loans to be treated as exempt

Commission in lieu of exchange

Escrow fees

Salary and pension payments - Fees

Institutional Banking

5%

Telex charges

Admin and all other fees

Exempt

Interest received from other banks

Assignment of debt with full recourse

Issue or transfer of debt Securities

Asset finance – lending component of instalments (if interest)

Securitisation of debt security

Interest adjustment

Transfer of a loan portfolio

Interest on late payment

Transfer of debt security

Interest subsidy from dealer/manufacturer

Sale of debts or receivables

OOS

Correspondent bank charges

Principal component of Instalments

Corporate Finance/ Investment banking

5%

All fee based services

Exempt

Interest on loans

Treasury and Financial Markets

5%

Admin fee / Ta'widh (late payment compensation)

Managing the issue, placement, underwriting of new and existing Securities

Fee for acting as receiving banker in connection with issue or placing of shares, stocks, etc.

Arrangement fee for underwriting, purchase or sale of bonds

Handling charges for payment or collection of dividends, principal or interest in respect of securities

Exempt

All types of interest income

Interbank Investment / Placement:
- Hibah received on Wadiah Placement
- Profits from Mudarabah Interbank Investments (MII) and commodity Murabaha placement

Holding of Islamic Securities:
- Profits earned from holding of Islamic capital market instruments, i.e. IMTN, Sukuk, etc
- Profits earned from holding of Islamic money market instruments, i.e. Islamic negotiable instruments, etc.

Trading gain on sales of Held-for-Trading (HFT) securities

Trading gain on Bonds / Notes / Derivatives / Trading securities

Trading as Principal - Government Stock, Treasury Bills and Other Capital Market Transactions, Debentures etc.

Gain gain on sale of Islamic Securities

Capital gain on sales of Available-for-Sales (AFS) Securities

Discount on Purchase of Fixed Income Instruments

Income from FX forwards, FX revaluations, market to market, etc.

Issue of securities

Supply of a futures / forward / swap / option agreement, where there is no physical delivery of the underlying commodity

Trading income earned on underlying securities

Trading gains

Full underwriting activity (where there is no explicit fee)

Issuance or sale of bonds

OOS

Marked-to-Market gain on HFT securities

Actual revaluation on investments

Market to market gains on derivatives / structured products

Dividend income on investments

Capital gain on equity investments

Redemption for the principal value

Islamic Finance

5%

Explicit fees (as per non-Islamic products)

Ijarah - administration fee, assessment fee

Late payment charges (paid to charity)

Mudaraba - arrangement fee, administration fee

Murabaha / Tawaruq – Commodity charges or fee,
Administration fee

Wakala - Management fee, administration fee

Exempt

Fees made in accordance with Shariah law and
considered to be the equivalent of non-Islamic
Products

Mudaraba – profit margin

Profit on deferred payment terms

Wakala - Retention of excess profits

Ijarah – Financing income (margin)

Wakala - Profit margins

Mudaraba - Commissions based on profit
margin or other implicit margin

OOS

Murabaha / Tawaruq – purchase and sale of
supplies

Ijarah - purchase of assets by bank

Ijarah - Principal component of instalments

Our Comments

The much awaited guide issued by the FTA provides detailed listing of activities carried by Financial Services Industry and provides important VAT clarification on the following:

- Services provided free to all / specific customers (if it does not qualify as a deemed supply) – Out of Scope
- Disbursements of expenses incurred on behalf of Customer – Out of Scope
- Issuance and redemption of loyalty points – Out of Scope
- Interest income earned on credit cards – Exempt
- Delayed payment penal interest charges – Exempt
- Dividend income – Out of Scope
- VAT treatment on various activities under Islamic Finance

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