VAT brief | Directors' liability

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keypoint

In its recently released VAT law, Bahrain's government has defined a wide range of penalties for administrative offences – as well as jail terms and significant fines for tax evasion. As expected, this has led to questions from directors and the C-suite, asking who is likely to be found liable if a company in Bahrain is found to have failed to comply with the legislation - or tried to evade VAT.

What's the background to this issue?

The ultimate responsibility for tax risk management and governance rests with the board of directors. If good corporate governance processes are in place, many key controls will already exist within an organisation. Good corporate governance models include a robust risk management framework and procedures to identify, implement and report on the design and operational effectiveness of the internal controls in place to mitigate identified risks. Some entities may wish to leverage their existing corporate governance practices as much as possible, such as the company's existing financial reporting internal control framework.

Tax risk management may not yet be an identified risk for many businesses in Bahrain. Having a strong tax control framework suggests that tax risks are well managed. Alternatively, the absence of a strong tax control framework may suggest tax risks have not been accurately assessed.

Three lines of defence

Leading practice suggests a 'three lines of defence' approach to risk management:

- Risk owners or management
- Risk management or a compliance function, which reviews and challenges activities and decisions
- Board committees and independent assurance functions

Board-level controls

The role of a director comprises oversight and monitoring, including ensuring effective governance processes and appropriate risk management frameworks are in place to ensure compliance with applicable laws and regulators' policies.

Managing day-to-day controls and processes to ensure compliance with tax obligations is not a matter for the board, but a responsibility of management.

The board of directors (or an authorised board level sub-committee) should oversee an internal control framework that provides guidance on how all risks, including tax risks, are identified and managed within the business. In addition to having effective controls in place to manage identified tax risks – such as formalised policies and procedures – you should be able to demonstrate that those controls have been operating effectively over the relevant period. This could be part of the same procedure that is used to demonstrate the effectiveness of all key controls.

Testing of internal controls

At a board level, directors should have a general understanding of internal controls, the board's oversight functions and the various points of communication where controls testing results are reported to the board.

Managerial-level controls

The role of a company director is to govern a company on behalf of the shareholders or members of the company. It is part of a director's role to assess the operational effectiveness of the key controls that form an entity's overall internal control framework. As part of oversight, directors should get comfort from management that managerial-level responsibilities have been met and demonstrated - based on evidence. This may be done in the form of assurance reporting from management to the board.

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Managing tax risk

The board and management need to establish a framework to manage tax risk. Matters to be considered include:

- The organisation's tax risk profile
- Agree an acceptable level of tax risk for day-to-day operations and what requires escalation
- Board (or sub-committee) endorsement for positions taken by management that may fall outside tax authority guidance
- Recruitment of staff with appropriate tax experience and skills
- Outsourcing the tax function or using external advisors to review returns and provide advice
- Role descriptions for tax compliance, administration and risk management
- Roles and responsibilities for reporting of tax matters
- Segregation of duties so that VAT and excise return preparation is segregated from review and authorisation before lodging
- Policies or committee charters that specify methods and frequencies for reviewing and escalating risks in the tax risk register, including follow-up of identified tax risks

Penalties

The penalties for tax evasion set out in Bahrain's VAT law are stringent with **imprisonment** of 3-5 years and a penalty equal to up to three times the amount of the VAT due for:

- Failure to register within 60 days of the deadline
- Failure to pay tax due within 60 days of the due date
- Incorrect input tax recovery
- Presenting fake documents
- Recovering input tax if ineligible
- Not issuing tax invoices
- Charging VAT on non-taxable supplies
- Failure to keep proper records

Fines of up to BD5,000/- apply to a range of **administrative** offences, including:

- Failure to cooperate with the tax authority
- Failure to update registration details
- Failure to display prices as inclusive of VAT
- Failure to submit requested information
- Failure to comply with tax invoice rules and procedures
- Violation of any provision of the law or its regulations

There are also penalties for late payments and submitting incorrect information that leads to under-declared VAT.

Liability

Directors are liable for the actions of their companies. Where a corporation commits a taxation offence, a person who takes part in the management of the corporation (such as a director) may be considered to have committed the taxation offence and may be punishable accordingly. Directors can become personally liable for tax evasion or administrative delays by the businesses on whose board they sit.

To discuss your responsibility and liability as a director of a Bahrain company, contact a VAT specialist on the Keypoint tax team.

Important note

The information in this document is based on translations of the draft Bahrain VAT law, the VAT laws and regulations of the UAE and Saudi Arabia, the GCC VAT framework and general VAT principles. It is provided for information purposes only. As the draft Bahrain VAT law has been recently released and is still being reviewed in detail, any comments on this law are preliminary in nature and are likely to change. Any omissions or errors are inadvertent. This document should not be relied upon in making any decisions. You should seek appropriate professional advice from a tax advisor before making any decision relating to your particular circumstances.