

# Sector spotlight | VAT and the oil & gas sector

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On Thursday 14 May 2020, Bahrain's National Bureau for Revenue (NBR) released its long-awaited VAT oil & gas guide. The guide includes oil & gas-specific examples - as well as sections dedicated to supplies of goods and services to the upstream, midstream and downstream sectors. Key takeaways from the guide include:

## Exploration rights

The granting of exploration, development and production rights by NOGA is outside the scope of VAT as it is considered an award in a sovereign capacity. However, any transfer of those rights may be zero-rated, or out of scope if transferred as a going concern.

Farm-in arrangements are considered barter transactions where work obligations undertaken by the *farmee* are exchanged for the value of the right transferred by the *farmor*. Under such arrangements, VAT treatments need to be evaluated based on the work performed - one side of the barter may be zero-rated while another is standard-rated.

## Cash call arrangements

The guide analyses three typical cash call models under a joint operating agreement (JOA) - where the operator acts as a principal or disclosed or undisclosed agent - from a VAT perspective. However, each cash call arrangement should be assessed on a case-by-case basis, depending on the transactions entered into, as they may have different VAT implications. With a joint venture (JV), the JV itself has a VAT registration requirement. Although one of the JV participants is appointed as a representative with the NBR, all JV participants remain jointly and severally liable for the JV's VAT obligations. Tax invoices for costs incurred by JVs and participating parties should be issued to the JV and VAT recovered through the JV's VAT return.

## Fixed establishments

The assessment of whether a non-resident business exploring, developing and producing hydrocarbons in a licensed area within Bahraini territory is carrying out its activities from a fixed establishment in Bahrain will be determined based on the exact facts.

The guide specifies that fixed and floating rigs and platforms should be considered as "fixed" and may therefore result in the existence of a fixed establishment for VAT purposes.

## Supply of staff or services

### Supply of staff

Where a third-party supplies staff to an oil & gas operator, several factors need to be considered including:

- Place of supply
- Are the personnel involved solely in technical activities (zero-rated) or do they perform other activities (standard-rated)?

### Supply of services requiring staff

Where a third-party supplies services that require on-site deployment of staff, the third party is considered to be supplying a service. The VAT treatment of any such service depends on the scope of the services and their nature.

## **Input VAT recovery on unsuccessful exploration and decommissioning of infrastructure**

Input VAT incurred on exploration that does not result in making taxable supplies is recoverable, subject to meeting the input tax recovery rules. This means that businesses are not required to make any adjustments to initially claimed input VAT. However, any input tax incurred on expenses after making the decision to stop operations, excluding decommissioning expenses, is not recoverable.

Participating parties during the exploration, development and early production stages may apply for VAT registration - despite not being able to project any turnover in the past and next 12 months - as long as they can demonstrate their genuine intent to conduct business and to make taxable supplies. This can be done by providing the NBR with a copy of operating/production agreement(s) listing them as participants entitled to a share in any oil or gas produced.

## **Borrow and return arrangements**

If there is no consideration paid for the borrowing of equipment or consumables, and these are subsequently returned to the owner, no supply has been made. The NBR has not classified this as a form of 'rental services for no consideration' which could have triggered a deemed supply.

On the other hand, swapping equipment or consumables - returning equivalent goods to what was originally lent but not exactly the same equipment - is a supply.

## **Oil & gas-specific zero-rating provision**

There is now guidance (including examples) on how to assess whether equipment and consumables can be viewed as directly and exclusively used in oil & gas activities and so qualify to be zero-rated. However, the guide does not specify the procedures required to prove to the NBR or Customs that parts or consumables are directly and exclusively used for oil & gas-related activities.

The guide specifies that the zero-rating generally applies to commodities falling under HS tariff headers:

- 2709, 2711 and 2714 for raw natural gas, crude oil and other hydrocarbons after extraction
- 2710 and 2713 for processed natural gas, waste oils and residues of petroleum oils

The zero-rating does not apply to used oil and products such as ammonia, urea, methanol, plastics, fertilisers or asphalt concrete.

## **Construction activities**

The guide confirms that the construction of refineries, petrol and liquefied natural gas (LNG) are not oil & gas activities - so the zero-rating provisions for oil & gas activities do not apply. However, these construction services can be zero-rated according to Article 76 of the VAT executive regulations.

Applying Article 76 - which covers supplies for the construction of new buildings - requires contractors supplying goods or services to new plants to meet all required criteria - including obtaining a new building permit from the building owner or the main contractor - before supplies can be zero-rated. This condition, in practice, has been challenging.

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## Petrol stations

The guide includes retail-side operating models. Petrol stations - if they have not done so already - must look into existing contractual agreements in light of clarifications in the guide.

Petrol station owners following a company owned dealer operated (CODO) model will need to assess whether the dealer acts as a disclosed or an undisclosed agent and evaluate the VAT implications accordingly. As the owner and operator are the same in the company owned company operated (COCO) and dealer owned dealer operated (DODO) models, the owner is the party liable to apply the correct VAT treatment.

## Security deposits on LPG containers

Refundable security deposits paid on returnable LPG containers are out of scope as they are not a consideration for a supply. However, if a security deposit is subsequently applied by the supplier to reduce an amount due for a given supply, the deposit must be treated as consideration.

If returnable containers are damaged or not returned, forfeited security deposits are viewed as a form of indemnity – so no VAT applies.

## Swapping of raw materials or crude oil

In line with overarching VAT concepts, the swap of raw materials or crude oil is viewed as a form of supply and the consideration corresponds to the fair market value of what is being received. The supply is zero-rated if the swapped raw material or crude oil is subject to VAT at the zero-rate.

**Disclaimer:** This sector spotlight is based on our review of v1.0 of the NBR's VAT oil & gas guide, our understanding of Bahrain's VAT legislation and the GCC framework agreement and general VAT principles and is for general information only. Seek professional advice in relation to your particular circumstances.

## Other areas

There may still be VAT issues that require further assessment, such as:

- Treatment of profit or commission shared between participating parties
- Implications of capital injections made by an operator to participating parties
- Treatment of interests relinquished by one participating party to another party
- The return of rights by participating parties to NOGA - although the granting of rights by NOGA to participating parties has been clarified as out of scope
- How suppliers of consumables to customers operating in the oil & gas sector can assess whether goods will be used solely for oil & gas activities