

VAT alert | Bahrain approves VAT law

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Bahrain's VAT law was passed by the Chamber of Deputies on 7 October 2018 and by the Shura Council a day later. Decree 48, not yet published in the Official Gazette, is a significant step towards Bahrain's planned implementation of VAT on 1 January 2019. It is also a welcome development for Bahrain's businesses, which have been eagerly awaiting confirmation of the arrival of the tax and its application to their industry sector.

Released in Arabic, the decree has been translated by Keypoint's Arabic VAT specialists and, in conjunction with Keypoint's experienced VAT team – the largest dedicated VAT team in Bahrain – we highlight here some of the most significant impacts affecting all businesses and specific impacts for some of Bahrain's key industry sectors.

What is VAT?

- VAT is a tax on consumption, not income or profits.
- The GCC countries have agreed a standard VAT rate of five percent.
- The supply of goods and services can be exempt, zero-rated or standard-rated (five percent), or out of scope.
- The mandatory registration threshold is the equivalent of US\$100,000 - as set out in the GCC VAT treaty. The voluntary registration threshold is the equivalent of US\$50,000.
- Registered businesses account for VAT on the price charged for the goods or services they supply and pay it to the tax authority on a regular basis.
- Registered businesses should (where the supplies they make are either standard- or zero-rated or out of scope with recovery) be able to recover the VAT they have incurred in the course of making those supplies.
- Registered businesses that make supplies that are exempt from VAT cannot recover the VAT they have incurred in the course of making those supplies.
- Registered businesses may not be able to recover the VAT they have incurred on certain purchases that are deemed to have a private element.

- Registered businesses that make supplies that are predominantly zero-rated are likely to be in a VAT refund position.
- Businesses that make both exempt and taxable supplies can only recover a proportion of their input VAT.

Issues for all businesses

Penalties

Penalties for non-compliance and non-payment of tax are similar to the rest of the GCC, with tax-geared, percentage-based penalties for under-declarations of tax, failures to pay, and specified penalties for administrative failures – such as failing to register for VAT (up to BD10,000) or failing to submit information to the tax authority (up to BD5,000).

The most significant development for businesses in Bahrain is the definition of tax evasion - an offense subject to imprisonment. Errors in the calculation of input tax, or the failure to register or pay tax if neglected for long enough, may result in a prison sentence of up to five years, in addition to being required to pay a multiple (of up to a factor of three) of the tax due.



Transitional provisions

Suppliers to government may zero-rate supplies made under those contracts, provided they are entered into prior to 31 December 2018 with the zero-rate applying until 2023. This will be welcome news to suppliers dealing with the public sector, concerned that they will be unable to charge additional VAT amounts, particularly for long-term contracts spanning the date of implementation.

However, it appears that this relief only applies to government contracts, with no such relief applicable to solely private sector contracts spanning 1 January 2019. Customers and suppliers who have entered into such contracts should begin discussing who will pay the VAT chargeable now. Ultimately, however, if a contract does not allow a supplier to unilaterally increase its price and the customer does not agree to pay, the requirement to pay VAT to the government on the supply remains with the supplier, who will be out of pocket.

As we saw in the UAE and Saudi Arabia, Bahrain's transitional provisions guard against the making of significant prepayments or advance invoicing prior to the date of implementation to try to avoid paying VAT. The law stipulates that where payment is received, or an invoice is issued prior to implementation for supplies of goods or services to be delivered after 1 January 2019, VAT will still be due.

Further details on the precise application of these rules are expected to be contained in the implementing regulations that are expected imminently.

Reverse charge on imports

As we saw in Saudi Arabia, VAT is chargeable on goods imported into Bahrain. Unlike the UAE, there is no automatic application of the reverse charge. However, the law does stipulate that businesses, provided they have applied and that request is approved, may be able to account for their imports by way of reverse charge.

The ability to simultaneously offset an input tax credit against an output tax liability on the VAT return potentially represents a significant cash-flow advantage for businesses making a large number of imports who are entitled to full input tax credit on those purchases.

Additional VAT legal definitions

The Bahrain VAT law contains 53 legal definitions – more than the 40 published in the GCC VAT Treaty. The additional definitions will help Bahrain businesses, particularly where they are new to the concept of VAT, to understand the application of the tax.

Sector-specific developments

Oil and gas

The law specifically zero-rates oil, oil derivatives and supplies of gas. The application of the zero-rate in the law is broad. We expect consumers will eagerly await confirmation in the regulations as to whether VAT applies to supplies of petrol at the pump.

Suppliers making zero-rated supplies are not required to charge VAT to customers and are entitled to credit for local VAT suffered on purchases. However, suppliers making predominantly zero-rated supplies, where their input tax credit exceeds output tax payable, will want to understand when their repayments are likely to be received, or otherwise roll forward to redeem against future liabilities.



Where those affected business have a large amount of imported goods, the ability to reverse charge, and obtain an immediate tax credit, as outlined above, may represent a significant cashflow relief.

Financial services

Similarly to the UAE and Saudi Arabia, VAT applies at the standard rate (5%) to supplies of financial services where the consideration payable is by way of a fixed fee, commission or commercial discount. Financial services for which the consideration payable is by way of an implicit margin, such as interest on loans or forex spreads, are exempt from VAT.

There is no mention yet as to whether VAT applies on supplies of life insurance or securities. This may be clarified further in the regulations, or alternatively may be a deviation to the application of VAT to such supplies in the GCC to date.

Retail

In a move that will be welcomed by consumers in Bahrain, the supply and importation of certain foodstuffs has been zero-rated. Our expectation is that the application, to be clarified in the regulations, will apply to basic food items such as vegetables, grains, meats and dairy, with the likely application of the standard (5%) rate to luxury items such as confectionery, soft drinks and toiletries.

Significant for the Bahrain pearl industry is the zero-rate applicable to supplies of certified authentic pearls. The zero-rate also applies to certified authentic gemstones and investment metals of purity greater than 99%. The application of the zero-rate, although welcome for the jewellery industry, creates complexity, particularly in scenarios where zero-rated gemstones are supplied as part of a piece with non-investment grade metals.

Healthcare

Following the UAE example, supplies of basic and preventative healthcare, related services, medicines and medical goods are zero-rated. The zero-rate is not expected to apply to cosmetic surgery or treatment.

Further clarity on the meaning of basic and preventative healthcare to determine the exact application of these provisions is expected in the regulations or government-issued guidance.

Education

Bahrain has applied the zero-rate to supplies of all forms of education, including the supply of related goods and services by education institutions.

The application of the zero-rate is broad. The application of the zero-rate to connected goods and services needs to be clarified – for example, whether it applies to uniforms, books and other similar materials – and we will have to wait and see whether the zero-rate extends to supplies of vocational training, which are excluded from the definition of 'education' in other jurisdictions.

Real estate

The supply by sale or lease of bare land and 'buildings' is exempt from VAT. This application to bare land is similar to the UAE, which exempts sales. Bahrain has extended this to include leaseholds. The definition of buildings requires further clarification. We expect the exemption to apply to the sale and lease of residential property and not to commercial.

For businesses making exempt supplies, related input tax is not recoverable.



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Transport

The GCC VAT treaty currently zero-rates the international transportation of passengers and goods, and imposes this treatment on member states. Bahrain has extended the zero-rating to include local transportation. The extent of the zero-rate will need to be clarified, but we expect private transport such as taxis and leisure transport to be subject to VAT at 5%.

Transport providers, while not required to charge VAT to their customers and entitled to recover VAT incurred on related costs, may find themselves in a difficult cash-flow position if they are required to wait for VAT repayments from the tax authority.

The above highlights are not intended to be an exhaustive analysis of the recently announced Bahrain VAT law, and are based on a translation of the draft Arabic decree. We expect further clarification and detail in relation to the full application of the tax in the coming weeks, particularly in the regulations that will accompany the law. As always, if you have any questions, or would like to discuss any of the issues raised in this VAT brief, please get in touch with your Keypoint VAT contact.

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 the draft Bahrain VAT law are preliminary in nature and 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.