

Bahrain VAT Law: What does this mean for you?

October 2018

In brief

Last week, the Council of Representatives and the Shura Council of the Kingdom of Bahrain approved the **Decree-Law No. (48) of 2018 on Value Added Tax (VAT)**. This confirms that VAT will be implemented in Bahrain from 1 January 2019. Although the Law covers the general principles for the application of VAT in Bahrain, the VAT Executive Regulations, when issued, will provide further details on the application of the Law.

With fewer than three months to go until the introduction of VAT, businesses immediately need to understand the implications of the VAT Law for them and take the actions needed to comply with VAT from 1 January 2019.

In detail

Following the introduction of VAT on 1 January 2018 in the Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE), Bahrain will introduce VAT from 1 January 2019. Although the Law covers the general principles for the introduction of VAT in Bahrain, the Executive Regulations will provide further details on many of the principles outlined in the Law, including those goods and services that will be zero-rated or VAT exempt.

Based on the VAT Law as enacted, there are some clear differences between the VAT system to be introduced in and those implemented in KSA and the UAE.

We set out below our analysis on some of the key areas of the VAT Law and issues for businesses to consider.

Zero rated and exempt industry sectors

The VAT Law sets out sectors which will be zero-rated or exempt from VAT. The precise application, scope and conditions relating to the zero rating or exemption will be provided in the Executive Regulations. We have summarised the main provisions below

Oil and Gas (O&G) sector

Zero rating will apply to the oil sector and to oil and gas derivatives.

The Law does not specify how broad the “sector” will be for the purposes of the zero rating, nor the extent to which it will apply to upstream, midstream and downstream activities. The wording of the Law is wide enough to potentially zero rate the entire sector including products such as fertilisers, petrochemicals and plastics and it remains to be seen whether the scope of the zero rating is narrowed in the Executive

Regulations. It is also not clear from the Law whether the zero rating applies on supplies between taxable persons only, or whether supplies to final consumers (e.g. petrol bought at the pump) will also be zero rated.

Financial Services

The VAT Law provides that the supply of financial services is dependent on whether the services are remunerated by way of an implicit margin or an explicit fee, commission or commercial discount. To ensure equity in the VAT treatment between Islamic and conventional financial products, Islamic financial products that are Shariah compliant, and which are meant to achieve the same result as the conventional financial products, are expected to be subject to the same VAT treatment as conventional financial products.

Given the importance of the financial services sector to the Bahrain economy

coupled with the complexity of the sector, we expect the Executive Regulations to provide a detailed listing of the exempt financial products.

We expect that general insurance/reinsurance will be taxable at the standard 5% rate. The Law does not address whether life insurance / reinsurance will exempt as is the case in KSA and the UAE.

Real Estate

Bare land and sale/rental of real estate

Supplies of bare land and the sale and rental of real estate will be exempt from VAT. The Law does not distinguish between residential and commercial real estate, and we therefore expect the exemption to apply to both.

We expect that the Executive Regulations may limit the exemption so that it may not apply to hotels, certain serviced accommodation and other holiday accommodation. The VAT treatment of employee accommodation and related goods and services are unclear at this stage.

Construction of new buildings

The construction of new buildings will be zero rated. The Law does not define the term “new building” or set out what goods and services will qualify for zero rating. We expect that the Executive Regulations will set out how construction will be defined, what will constitute a new building and whether related goods and services will also fall under the zero rating. We

also expect clarification on the treatment of refurbished buildings, demolition and new extensions.

If related goods and services are excluded from the zero-rating, businesses will need to consider whether a turnkey / design and build contract may be more favourable from a VAT perspective rather than procuring separate goods and services.

Unlike the UAE Law, there is no specific reference to the conversion of buildings. This therefore raises specific questions on whether this will be included or excluded from the exemption.

Education

Zero rating will apply to educational services and related goods and services for kindergartens, pre-primary education, primary, secondary and higher education. Although similar to the UAE, questions remain on whether this will cover all education provided under these categories, or whether it will be for education provided by specific education providers only (for example, those institutions recognised by the Ministry of Education in Bahrain). It is also unclear whether the zero rating will apply to professional qualifications, vocational training and online courses.

We expect that the Executive Regulations will provide more clarity on what goods and services will be considered as relating to educational services and thus zero rated. Such goods and services include, uniforms, school books,

school meals, school trips and electronic devices used for educational purposes.

Healthcare

All basic and preventive healthcare services and associated goods and services as well as imports of medicines and medical equipment will be zero-rated. The Law does not define these terms. We expect that the zero rating will apply only to hospitals and clinics that are licensed in Bahrain. We also expect that, similarly to the UAE, cosmetic treatments will be excluded from the zero rating.

Despite the zero rating, hospitals are likely to have supplies taxable at the 5% rate such as items sold in gift shops and cafes, and accommodation provided to relatives of patients.

Basic food items

That the sale and import of specified basic food items will be zero rated. Although the details of this will be provided in the Executive Regulations, it is expected that this will cover basic food items, such as bread, milk, meat/fish and eggs. It remains to be seen whether the list of qualifying food products will be extensive, or open to interpretation. In other mature VAT jurisdictions, such as the UK, there have been court cases on whether a particular food item falls within the list of products that are zero rated.

We expect that food supplied in the course of catering (for example at restaurants) or “non-basic items” such as confectionary and soft drinks will be

taxable at the standard rate of 5%.

Supermarkets and food retailers will need to ensure that their point of sale systems are configured correctly so that the zero rate will be applied to qualifying basic food items and that the 5% standard rate applies to other products.

Local transport

The provision of local transport will be zero rated, but no conditions are specified in the Law. We expect that the zero rating will apply to the domestic transport of both passenger and goods, but it remains to be seen whether, for passengers, the treatment will be restricted to public transport.

Similarly to the UAE, we expect some exclusions to be clearly identified in the Executive Regulations. For example, the zero rate may not apply to any local transport for pleasure and recreational purposes.

Certified pearls and precious stones

The supply or import of certified pearls and precious stones will be zero-rated for VAT purposes. The Executive Regulations are expected to define what type of pearls and precious stones will be included under the zero-rating provisions as well as how such stones may be certified.

Payment of tax on importation of goods

VAT will be payable to the Customs Authority on the

import of goods. A taxable person will be entitled to deduct this VAT on its VAT return if all input tax recovery conditions are met.

The Executive Regulations may allow the importers who are taxable persons to defer the payment of VAT until the submission of their next VAT return. This is the system applied by the UAE and, if applied in Bahrain, this would significantly reduce the cash flow impact on taxable persons who are importing goods.

Transitional provisions

The transitional provisions in the Law and the Executive Regulations will set out how VAT will be applied on supplies that span the VAT implementation date of 1 January 2019. For contracts with government bodies, supplies made under a contract signed with the Government before 1 January 2019 will be treated as zero rated the contract is renewed, it expires or 31 December 2023, whichever is the earliest.

For all other contracts, VAT will be imposed on goods delivered or services completed after 1 January 2019. Where a contract has a VAT clause, the price payable will be increased by the VAT amount. Where there is no VAT clause, the contract price will be deemed to be VAT inclusive, meaning that the person supplying the good or service will bear the VAT cost.

Based on our experience in the UAE and the KSA, the transitional rules are likely to be challenging for

businesses where contracts have already been signed without a tax clause. Also, businesses who have signed contracts with consumers spanning 1 January 2019 (e.g. insurance or gym membership), may find it difficult in practice to recover the VAT cost from customers, even where the contract has a VAT clause.

Businesses will need to consider the impact of the transitional provisions on their contracts. In particular, businesses will need to assess how they may be affected by contracts that do not have a tax clause as they could be exposed to a VAT cost.

Provisions on compliance and penalties

The VAT Law does not set out any detailed provisions on compliance requirements such as the frequency of filing of VAT returns, the content of a VAT return, requirements for tax invoices etc. We expect these to be included in the Executive Regulations. In addition, the Law does not indicate whether, similarly to KSA, a higher registration threshold will apply for 2019 to facilitate a phased introduction of VAT and providing smaller businesses more time to become VAT compliant.

We have described below some of the provisions in the Law relating to penalties and tax evasion.

Administrative Penalties

The VAT Law sets out administrative penalties that will apply in case of specific violations, such as the late submission of a VAT

return or failure to register for VAT. Similarly to the KSA and the UAE, penalties will either be a percentage of the tax or a fixed penalty.

The Bahrain VAT Law provides for imprisonment in some serious cases (for example, tax evasion) which highlights the severity of non-compliance with the VAT Law.

From a practical perspective, businesses will need to ensure that they will be in a position to comply with their VAT compliance with effect from 1 January 2019 to ensure that they are not at risk of any penalties and fines. We are expecting further details on VAT compliance (for example, the VAT registration process) to be shared by the Ministry of Finance in due course.

Tax evasion

Article 63 of the VAT Law contains provisions on tax evasion. The penalty for tax evasion is imprisonment and a fine. Tax evasion is defined to include:

- Failing to register for VAT within a certain time frame
- Failing to pay a VAT liability by a certain date
- Providing forged or artificial documents, records or invoices with the intention of not paying tax
- Errors in the calculation of input tax
- Issuing tax invoices for non-taxable supplies.

The takeaway

Given that VAT will be introduced is less than three months, it is expected that there will be a number of updates from the Ministry of Finance over the coming weeks.

Businesses should immediately consider the impact of the Bahrain VAT Law on their business and what steps they need to take to ensure they are ready to comply with the new VAT system from on 1 January 2019.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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