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Value Added Tax (VAT) in Bahrain

Regional requirements, local adaptations

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Bahrain implemented VAT on January 1, 2019. This poses certain challenges which taxpayers will need to deal with in a very short space of time.

These challenges can be categorized in the following ways:

- Practical challenges in terms of the steps that need to be taken during the implementation process
- Management challenges in terms of understanding the process that needs to be addressed in order to ensure that business is compliant from day one.

In order to understand the impact of these challenges, it is useful to reflect on the implementation of VAT in the United Arab Emirates (UAE) and Kingdom of Saudi Arabia (KSA). We have set out some of what we consider to be the most important aspects below.

With limited time, we need to consider what is required immediately to be compliant from the first day of registration. Even where the business may have experienced VAT implementation elsewhere, there will be differences or unique factors to be considered in Bahrain.

Main challenges likely to be replicated in Bahrain

- **This is a major systems, accounting, and commercial change**
  An overriding challenge in the UAE and KSA was an underestimation of the scope and level of effort required to implement VAT. Dealing with a new tax, coupled with significant business and systems changes that are required, put a lot of pressure on businesses. The ability to identify, mitigate, and manage risk will be essential.

  Pricing will also be a critical consideration. Will VAT be absorbed in the current pricing structure or will it be passed on to customers? Can it be passed on to customers under existing contractual arrangements? At the retail level, will competitors be absorbing the cost? VAT may have a major impact on margins for companies, which will need to be carefully considered, along with any systems changes required to reflect new pricing.

  At a practical level, will the organization be able to issue tax invoices when its VAT registration takes effect?

VAT is a transaction tax that impacts on the full supply chain in real time, and requires that a business interact with those counterparts with which it contracts, whether with respect to procurement or sales.

- **It will impact all aspects of the operations of business**
  Businesses need to ensure that they can deal with a new business model that incorporates VAT into their systems. This means addressing processes and procedures, the risk management and compliance approach, plans for dealing with the supply chain, and commercial strategies. VAT is a transaction tax that impacts on the full supply chain in real time, and requires that a business interact with those parties with which it contracts, whether with respect to procurement or sales.

  This requirement to interact forces business to engage with its supply chain in order to make the decisions required to cope with the imposition of VAT.

- **Publication of the Bahrain VAT Law and Regulations**
  With the release of the Bahrain VAT Law and Regulations, both of which are now in unofficial bilingual form, many of the formerly "grey areas" now have a degree of clarity. The Gulf Cooperation Council Unified VAT Agreement (the VAT Agreement) provided a level of discretion at the national level in respect of key areas. The Bahrain position on these areas has now been defined, for example:
  - Food. For the first time in the GCC VAT implementation a member state has elected to apply the zero rate on certain food items. The specific items of food that are captured in this treatment can be found on the list of basic food items issued by Bahrain's National Bureau of Revenue (NBR), but excludes items supplied by a restaurant or café.
  - Real Estate. Where the UAE and KSA apply various VAT treatments to the lease and sale of buildings depending on use (residential verse commercial) and its age, Bahrain has taken the approach of treating the lease of all buildings (including commercial buildings) as exempt from VAT. This is a unique approach in the GCC and may increase compliance obligations and costs for landlords, for example. The practicalities of applying the zero rate to certain construction services may also be challenging.
  - Partial Exemption. Whereas the UAE determined the proportional recovery of VAT on overhead costs on a cost basis, Bahrain has taken a similar approach to KSA by applying a revenue method to this calculation.
  - Oil and gas sector. The zero rate for the oil and gas sector has been extensively applied, and incorporates not just the underlying hydrocarbon, but a wide range of goods and services supplied in the exploration and exploitation of oil and gas. Although this provides a cash flow advantage to those operating within the sector, it may create practical and compliance challenges within the supply chain.
  - Invoicing Requirements. With the release of Bahrain's VAT Regulations, the specific requirements of Tax Invoices are available. While these are largely in line with both the UAE and KSA, the availability of this clarity is welcomed by those businesses that already have an effective date of VAT registration.

  In addition to the discretionary areas

within the VAT Agreement, Bahrain has elected to implement a Domestic Reverse Charge (DRC) which can be taken up by those heavily involved in the trading of goods from Bahrain (to both GCC and non-GCC customers). This is optional, and seeks to limit the cash flow impact of VAT where traders will be in a continuous VAT refund position. The UAE has similarly applied an elective DRC for resellers within the oil and gas industry. Again, based on the experience in the UAE, although these sorts of arrangements limit the cash flow impact of VAT, in practice they do raise compliance challenges (often as the relief is felt by the customer, but the compliance risk may sit with the supplier).

There is is also relief within the Bahrain VAT legislation for specific sectors and goods which are not included within the VAT Agreement, such as the supply of pearls and precious stones. These unique characteristics must be identified for Bahrain, and existing expectations following experience in the KSA and UAE should be reconfirmed.

Having a system that can cope with different jurisdictional treatments will be key for businesses that operate in multiple countries, and for those that are tackling VAT for the first time, being able to apply these rules, and keeping up with changing interpretations, will be key to navigating and avoiding what are relatively harsh penalties for non-compliance.

- **Understanding the nature of the implementation process**
  While most finance teams have some experience in conducting financial transformation projects, few will have dealt with a project of the breadth or scope of a VAT implementation. This is simply because it has touchpoints throughout the wider organization which are often overlooked.

  The level of uncertainty on specific VAT positions will challenge many businesses, despite the availability of the legislation and NBR guidance. It is important to note that uncertainty remains in many areas of VAT in both the UAE and KSA. Lack of knowledge of the VAT rules should not be a factor delaying implementation. In this context, it may be difficult for many businesses to finalize their VAT accounting treatments in their IT systems until late in the implementation project. For Bahrain, this is further complicated by the extent of the application of the VAT exemptions and zero rating, and the fact that in some cases (such as within the oil and gas sector, and in respect of the DRC) the VAT treatment may be contingent on the status of the domestic customer or the industry in which a supply is consumed within.

  VAT is complex, and it can be seen from international jurisdictions that there will always be areas of ambiguity or lack of clarity. The key for VAT implementation it to start early, determine areas of uncertainty, assess the materiality, and take a risk based approach to progressing.

- **VAT registration**
  One of the most stressful practical hurdles encountered in the UAE was the requirement for information on the legal formation of the business for purposes of completing the registration process.

  In addition, even where that information was available, or could be obtained, it became important for the business to have access to the person that would be responsible for signing off on all aspects of the registration, as they would need to be available to do so, and possibly prove their authorization to do so.

  This was less of an issue in KSA, as they were able to work off the existing information held by the tax authority (GAZT), which is not something that can be relied upon in Bahrain.

  The phased approach to VAT registration in Bahrain, based on various turnover thresholds, while giving more breathing room for small and medium sized businesses, creates an added level of complexity both in terms of when a business is required to register, but also in relation to the extra costs that will be borne by these smaller businesses with regard to pre-registration input VAT costs. The Regulations seek to address the issue of pre-registration input VAT by allowing a mechanism for recovery of this cost. The requirements are fairly detailed, and impacted businesses should ensure they have processes in place to meet these requirements to minimise the cost of VAT before registration.

  Resident businesses must review turnover against the VAT registration thresholds immediately to confirm they are working toward the correct date that applies to their expected level of taxable supplies. The key dates for resident businesses are as follows:
  - December 20, 2018. For businesses with a taxable turnover of over BD 5m (for a January 1, 2019 effective date of registration)
  - June 20, 2019. For businesses with a taxable turnover of over BD 500,000 (for a July 1, 2019 effective date of registration)
  - December 20, 2019. Businesses with a taxable turnover in excess of the mandatory registration threshold of BD 37,500 (for a January 1, 2020 effective date of registration).

As a vital early step, businesses need to assess the capability of their ERP systems to deal with VAT. For those that have operations in the UAE and KSA, they are likely to have the advantage of at least having an ERP system that is able to be VAT compliant.

Consideration should also be given by resident businesses with a taxable turnover over BD 18,750 whether there is a benefit in submitting a voluntarily registration.

The turnover test is not relevant for non-resident businesses, who will be required to register for VAT in Bahrain for any taxable supply made in the Kingdom. Non-resident businesses that need to be VAT registered in Bahrain will need to consider either appointing a representative to fulfil this function for them, or alternatively they can apply to be registered by approaching the NBR. Similar to KSA, non-residents may experience practical challenges in obtaining a VAT registration in Bahrain.

It is usually recommended that businesses engage in the registration process as soon as possible so that they can be assured of having a VAT registration number available at the outset.

- **Lessons learned from previous VAT implementations**

The need for a strong project team

To achieve a successful outcome of an implementation project the business should, as a first priority, establish a project structure, and identify a steering committee consisting of members with a deep understanding of the day-to-day operations of the business and an effective project management function. The steering committee, using the skills and experience of outside advisors and those that have been through the process previously, should develop a full understanding of the impact that VAT will have on the business, so that it can move to addressing those touchpoints.

Some key challenges and pitfalls to be avoided include turnover in staff or project team members, which can be problematic throughout the project, so alternatives for the project team members should be identified at an early stage.

Where interpretation of the law is unclear, which is often the case even late in the project, options should be considered as to a Plan 'B'. Due to the inherent uncertainties, businesses should try to avoid setting unrealistic timelines and deliverables. At the same time, the day-to-day running of the business needs to proceed without interruption.

Systems considerations, ERP and otherwise

Companies should not underestimate the impact VAT will have on their ERP and other systems in order to ensure that they are compliant and risk is minimized. VAT will impact on the majority of systems transactions. Key considerations include:

- Configuring and setting-up tax codes for input (purchase) and output (sales) VAT;
- Master data cleansing and modification to allow for VAT determination, invoicing, and reporting;
- Consideration of what systems are impacted, whether a VAT 'bolt-on' is required, and how data will need to be migrated as systems are set up;
- Whether the VAT determination and reporting can be automated (in or outside the system); and
- Identifying linkages between relevant systems and data both inside and outside the organization.

Dealing with a new law

As VAT is a transactional tax, decisions need to be made in real time. Supply chains are often complex and difficult to unravel, and tax authorities guidance cannot cover every commercial scenario.

As a result, communication with your supply chain counter parties will be key. Are they going to be registered in time? Are you going to rely on any transitional rules, or are you going to agree on a renegotiation of existing contracts so that no one loses? If you are hoping to renegotiate – you need to do so from a position of understanding of the impacts on both your business and that of your supply chain.

Concluding thoughts

The key areas to focus on in terms of being ready for VAT implementation:

- Be realistic in your timelines and apply a risk based focus on the "must-have" as opposed to "nice to have". For example, make sure that you can issue invoices and collect VAT from customers, as opposed to having a bad debt relief process (or even a VAT reporting process) for day one
- Understanding the likely impact of VAT on the business's operations is essential – having someone who understands the business to lead the implementation team can be the difference between success and failure
- Make sure that you have an implementation plan that incorporates all of the stakeholders in the organization – it will not always be 'black or white'; allow for some flexibility
- VAT is complex, and even now the legislation and regulations are released, uncertainty on key transaction types remains. You are unlikely to have all the answers, but must determine the level of risk
- Do not be afraid to use advisors to guide you through the process; experience and knowledge can assist in the managing of risk and uncertainty.

The challenge can seem quite daunting at the start of the process, but as those who have been through the process will tell you, it's much like a visit to the dentist; you don't really want to go, but actually the pain was less than you thought it would be, and finally, once you've been you quickly forget about what all the fuss was about.

Contacts

Our local Bahrain indirect tax experts listed below would be happy to support with a one on one discussion to understand your specific needs and the implications of VAT on your business.

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