KINGDOM OF BAHRAIN

VAT FINANCIAL SERVICES GUIDE

MARCH 2019

VERSION 1.0

الجهاز الوطني للإيرادات

National Bureau for Revenue

Contents

1. Introduction

1.1. Purpose of this Guide

This document sets out some of the general principles of Value Added Tax (VAT) in the Kingdom of Bahrain (Bahrain) specifically relevant to the financial services and the insurance sectors. The main aim of this document is to provide the reader with:

- An overview of the VAT rules and procedures applicable to the financial services and the insurance sectors in Bahrain and, if required, how to comply with them
- The necessary background and guidance to help you to determine how a supply is treated for VAT purposes

This Guide is intended to provide general information only, and contains the current views of the National Bureau for Revenue (NBR) on its subject matter. No responsibility is assumed for the VAT laws, rules or regulations in the Kingdom of Bahrain. This Guide is not a legally binding document, and does not commit the National Bureau for Revenue or any taxpayer in respect of any transaction. This document should be used as a guideline only and is not a substitute for obtaining competent legal advice from a qualified professional.

Furthermore, this Guide should be read together with the VAT General Guide issued by the NBR and which is available on the NBR's website, www.nbr.gov.bh.

1.2. About the National Bureau for Revenue (NBR)

The National Bureau for Revenue (NBR) is the government body responsible for the implementation and administration of VAT in Bahrain. The NBR is responsible for the registration of taxpayer and their tax liability, the validation of VAT return filing and the related assessment, the payment of refunds and collection of any amount due, the auditing and processing of any appeal and the monitoring and enforcement of compliance.

1.3. Bahrain legal framework for VAT

VAT in Bahrain is codified under the following texts:

- The Unified Agreement for Value Added Tax of the Cooperation Council for the Arab States of the Gulf (the Framework) contains the VAT general principles and rules agreed at GCC level. The Framework was ratified in Bahrain by Decree-Law No. (47) for the year 2018
- Decree-Law No. (48) for the year 2018 regarding Value Added Tax (the VAT Law) provides the main rules and principles relating to VAT in Bahrain
- Resolution No. (12) for the year 2018 on the issuance of the Executive Regulations of the Value Added Tax Law issued under Decree-Law No. (48) for the year 2018 (the Executive Regulations) provide further details on the application of the VAT Law

The NBR may publish documents to provide guidance and/or clarify specific points relating to VAT rules. This may include guides like this one as well as public clarifications and interpretations of the VAT Law and the Executive Regulations.

2. Value Added Tax (“VAT”)

Bahrain introduced VAT on 1 January 2019. The standard rate is 5%. Certain goods and services are subject to a zero-rate (0%) of VAT and others are exempt from VAT.

2.1. What is VAT?

VAT is an indirect tax on consumer spending. It is collected on supplies of goods and services as well as on imports of goods and services into Bahrain.

Generally, VAT applies at 5% if a supply of goods and services is made:

- By a taxable person;
- In Bahrain; and
- The supply is not specifically exempted from VAT or subject to the zero-rate.

As a tax on consumption, VAT is paid and collected at every stage of the supply chain, with end consumers of goods and services bearing the cost.

For general information on VAT, please refer to the VAT General Guide issued by the NBR which can be found on the NBR’s website, www.nbr.gov.bh.

2.2. How does VAT work?

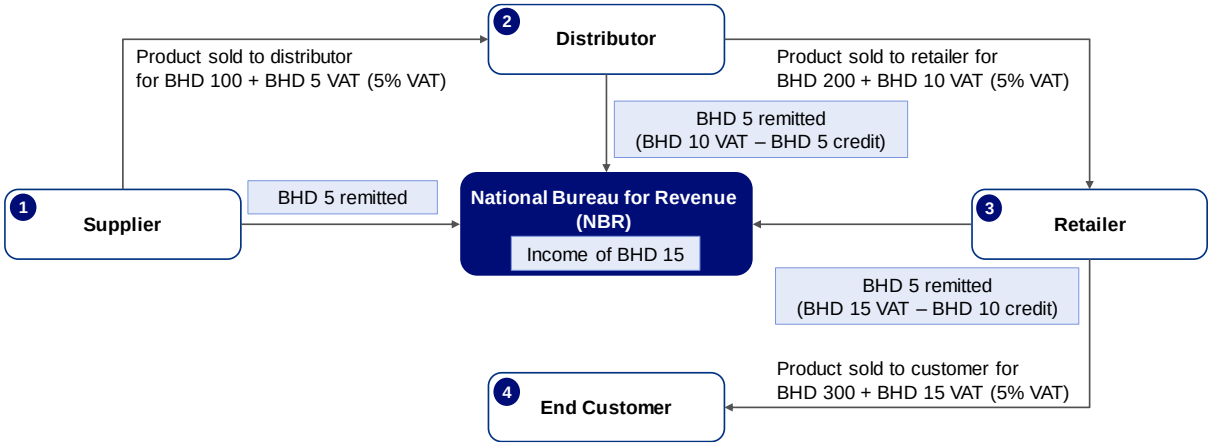
If, as a VAT registered person, you make taxable supplies (i.e., supplies of goods or services subject to VAT), you must charge VAT on your supplies, and pay it to the NBR. This is your “output tax”.

The VAT charged by your suppliers on your business expenses and the VAT you pay on your imports of goods and services is your “input tax”.

As a VAT registered person, you can reclaim from the NBR the input tax incurred on your purchases and imports to the extent that these expenses and imports are used to make taxable supplies. You cannot reclaim the VAT incurred on expenses used for a non-business activity or for making exempt supplies (i.e., supplies of goods or services that are not subject to VAT due to a specific VAT exemption).

On a regular basis, you will file a tax return to the NBR and pay the excess of your output tax over your input tax. If your input tax exceeds your output tax, you can ask for a refund of this difference from the NBR or you can carry it forward as a credit to use against future VAT liabilities. See the VAT General Guide for more information on how often a VAT registered business must submit a tax return and pay any associated VAT.

Figure 1: VAT collection across the supply chain



2.3. VAT treatment in Bahrain

A supply of goods or services taking place in Bahrain for VAT purposes can be subject to VAT at the standard rate of 5% or at the rate of 0% unless it falls within the scope of a VAT exemption.

This section provides an overview of the VAT treatment applicable to supplies of goods and services as well as imports of goods happening in Bahrain. If you are a taxable person, it will help you identify the correct VAT treatment applicable to your transactions in Bahrain.

Table 1: Summary of VAT rates and policies

Treatment	Overview	Output Tax	Input Tax
Standard rate	5% VAT applied on goods and services	5%	Deductible
Zero-rate	Supplies are taxable, but the VAT rate charged is 0%	0%	Deductible
Exempt	Supplies on which no VAT is charged and for which associated Input Tax is not deducted	N.A.	Not deductible

2.3.1. Supplies at the standard rate of 5%

Supplies of goods and services by a taxable person in Bahrain are generally subject to VAT in Bahrain at the standard rate of 5%, unless they are specifically subject to VAT at the zero-rate or exempt from VAT.

Where a supply of goods or services meets the criteria for zero-rating or exemption of VAT under the VAT Law and its Executive Regulations, this will prevail over the standard rate of 5%.

The conditions to apply VAT at the rate of 0% or to apply a VAT exemption must be interpreted strictly. Where these conditions are not met, the transaction will be subject to VAT at the standard rate of 5%.

2.3.2. Supplies at the rate of 0%

Zero-rated supplies are those which are taxable at the rate of 0%. This means that no VAT is actually charged on the supply, but the supplier can still claim the input tax charged on expenses incurred in making the supply.

Certain conditions must be met for the zero-rate to apply. If these conditions are not met, the supplies will, in principle, be subject to VAT at the standard rate of 5%, unless a VAT exemption applies.

2.3.3. Exempt supplies

Goods and services which are exempt from VAT are usually referred to as non-taxable supplies or VAT exempt supplies. A supplier is not required to charge VAT on these supplies and, as a result, is not entitled to recover the input tax charged on his expenses used in making these exempt supplies.

3. Definition of Implementing States

The concept of an “Implementing State” is critical when looking at transactions in the financial services and the insurance sectors for VAT purposes, which are the transactions this Guide considers.

The status of “Implementing State” is given by the VAT legislation to a GCC Member State that has implemented a national VAT legislation compliant with the Framework and that recognizes Bahrain as an Implementing State.

Transitional provisions

Bahrain does not currently recognize any other GCC Member States as Implementing States for the purpose of VAT. Until further notice, any transaction involving another GCC Member State is treated, for VAT purposes, as a transaction involving a non-Implementing State.

As a result, any supplies of goods or services from / to a GCC Member State are currently considered as made from / to a non-Implementing State. Also, residents of the GCC Member States are currently subject to the same rules as residents of non-Implementing States.

Intra-GCC supplies of goods (i.e., supplies between Implementing States) will be treated as exports / imports of goods until the Electronic Service System is in place and applied in all Implementing States. It is only then that the specific VAT rules applicable to Intra-GCC supplies of goods will become applicable. The Electronic Service System is the system to be implemented by the GCC member states enabling them to capture the details of all the cross-border transactions happening within the territory of the GCC.

4. VAT overview of financial services

The purpose of this section is to provide you with guidance on the VAT treatment of financial services supplied in Bahrain by a taxable person.

4.1. Overview of the VAT treatment

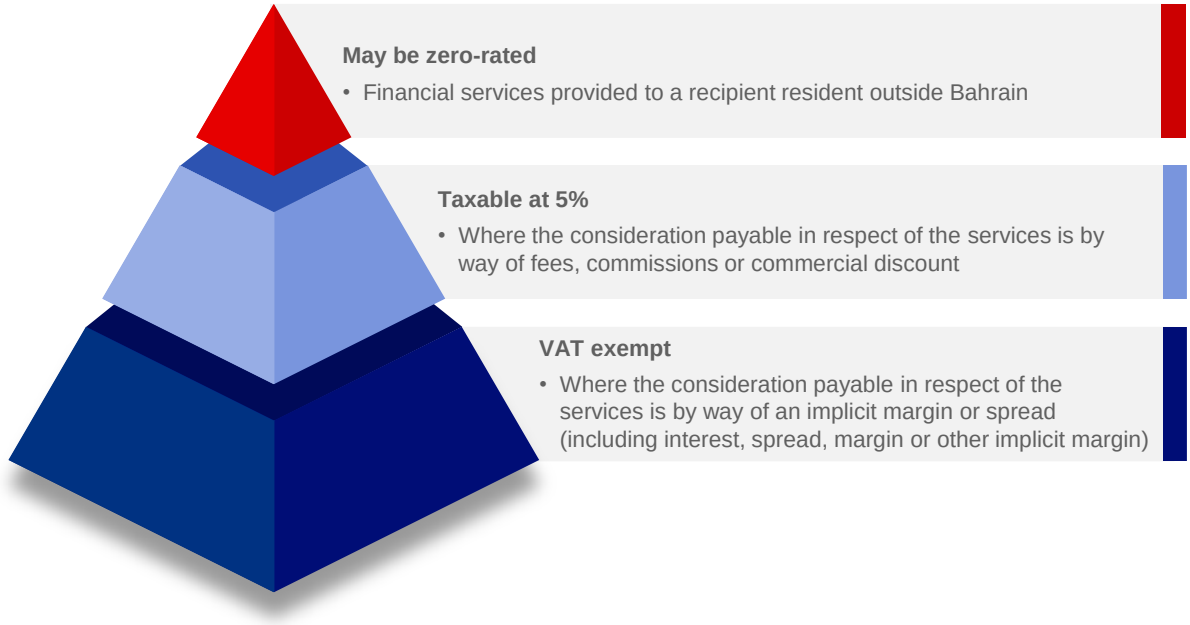
Under the VAT Law and the Executive Regulations, services qualifying as “financial services” are exempt from Bahrain VAT when certain conditions are met.

When the conditions for the VAT exemption are not met, financial services supplied in Bahrain will be subject to VAT at the standard rate of 5%. These are mainly financial services remunerated by way of an explicit fee, commission or discount.

Financial services meeting the conditions to be regarded as exports of services will be subject to VAT at the zero-rate. The zero-rate treatment will always prevail over VAT at the standard rate or a VAT exemption.

The figure below outlines the broad principles of VAT treatment of financial services in Bahrain.

Figure 2: Principles of VAT treatment for Financial Services



A VAT exemption means that no VAT is chargeable on the supplies made. Consequently, VAT charged on expenses incurred by the supplier for the making of these exempt supplies cannot be recovered.

When a supply is taxable for VAT purposes, this means that VAT is chargeable on the supplies made (either at 5% or at 0%). Consequently, VAT charged on expenses incurred by the supplier when making these taxable supplies can be recovered.

Most of the time, suppliers in the financial services sector will perform both taxable and exempt supplies and most of their expenses will be used in the making of both taxable and exempt supplies. As a result, the supplier will only be able to partially recover the VAT charged on these expenses.

Please consult section 9 for further details on the recovery of input tax.

4.1.1. Definition of financial services

Financial services are services that directly relate to money, financing, debts and other financial securities as well as fund management.

The Executive Regulations provide a non-exhaustive list of operations that are regarded as "financial services" for the purposes of VAT, as shown in Table 2.

Table 2: Categories of financial services for VAT purposes (non-exhaustive)

Service type	Overview	Examples
Money related services	• Services typically performed by banks or similar organisations in connection with the operation of current, deposit or savings accounts	• Administration of a bank account, provision of cheque books, direct debit orders • Issue of credit cards, dishonoured cheques • Remittance and money transfer services, payment services to merchants, interchange services • Foreign currency exchange services, trading in foreign currencies • Convenience services, interchange services • Services related to the issue of letters of credit, provision of financial guarantees
Credit and financing services	Lending or advancing money to customers in consideration for interest payments	• Granting of secured and non-secured loans, granting of overdrafts or lines of credit, syndicated loans, hire-purchase, finance lease arrangements

Service type	Overview	Examples
		• Intermediary services • Loan servicing
Debts and debts related services	• Transactions dealing with debts and their recovery	• Factoring • Forfaiting • Securitization • Debt collection
Capital and money markets	• Issue, allotment, renewal, amendment, rent or transfer of ownership of a debt or equity security (whether listed or unlisted)	• Issue and sale of shares, bonds • Underwriting services • Securities lending • Brokerage services • Listing, clearing and settlement, registrar, nominee and other services
Financial derivatives	• Supply or issue of financial derivatives or deferred contracts or any necessary arrangements for them • Provision or transfer of financial instruments, swaps, options, or any futures contracts	• Supply of forwards, futures, options • Swaps • Brokerage services
Asset management	• Investment management services (i.e., direction of a client's cash and securities by a financial services company)	• Discretionary asset management • Investment advisory services • Brokerage / execution services • Collective investment schemes
Islamic Finance products	• Islamic finance products provided in accordance with legally approved contracts, which are similar to conventional financial products in terms of the	• Murabaha • Commodity Murabaha / Tawarruq • Ijarah / Ijarah followed by a sale

Service type	Overview	Examples
	intended objective and materially achieve the same result	• Musharaka • Mudaraba • Wakala • Kafalah • Islamic bank cards • Sukuk
Insurance and life reinsurance	• Provision or transfer of ownership of a life insurance or reinsurance contract • The provision of insurance cover or an annuity under any investment scheme	• Provision of life insurance / reinsurance cover or life Takaful / re-Takaful • Transfer of life insurance / reinsurance contracts • Brokerage and agency services

From a regulatory perspective, financial services must generally be supplied by businesses that are specifically regulated and licensed by the Central Bank of Bahrain.

However, for VAT purposes, it is not required that the business is specifically regulated for its services to be regarded as “financial services”.

The “financial” nature of a service from a VAT perspective, is linked to the features of the service itself, as opposed to the regulatory status of its supplier. The provision of “financial services” for VAT purposes is therefore not reserved to banks or other regulated financial businesses. For instance, the provision of an interest-bearing loan is a financial service for VAT purposes whether the loan is made by a regulated bank or by any other taxable person.

Example 1

A taxable person, whose core business activity is the construction of real estate in Bahrain, grants an interest-bearing loan to one of its subsidiaries which needs cash to acquire a piece of equipment. The construction company, which is making cash available to its subsidiary against payment of an interest, performs a financial service for VAT purposes. The VAT treatment of this service will be the same as the one applicable to a similar service when supplied by a regulated financial business.

Example 2

A retail store, selling electronic products, offers its customers to pay their purchases in 10 installments with application of an interest rate which is disclosed and charged separately from the acquisition price of the goods.

The retail store, which is providing a credit to its customers against payment of a specific consideration (i.e., interest rate), performs a financial service for VAT purposes. The VAT treatment of this service will be the same as the one applicable to a similar service when supplied by a regulated financial business.

4.1.2. VAT exemption for financial services

A financial service will be exempt from VAT if the income earned by the supplier is by way of interest, a profit margin akin to interest or by way of an implicit margin.

The implicit margin condition is usually met when the supplier specifically seeks to generate income by actively trading an asset (e.g., money, securities, financial derivatives contracts, currencies) at a higher price than its acquisition price (e.g., realizing a spread, mark-up or profit), while bearing the risk of loss.

Financial services supplied in exchange for an explicit fee, a commission or a commercial discount do not fall within the VAT exemption and are therefore subject to VAT at the standard rate of 5%.

A commercial discount is any identifiable amount which is withdrawn ("discounted") from another payable amount and which constitutes the remuneration for a specific supply of goods or services.

Financial services remunerated by way of an explicit fee, a commission or a discount generally do not involve trading an asset with the aim to generate a margin based on the asset's trading price. They are typically triggered by the actual performance of a service by the supplier.

Some services may be remunerated by way of both a fee and an interest or implicit margin. For such services, each component of the remuneration will have its own VAT treatment:

- The fee will be subject to VAT at the standard rate
- The margin realized will be VAT exempt

Example 1

Company A, a taxable person established in Bahrain, offers foreign currency exchange services to customers in Bahrain against payment of a commission. For each exchange service, Company A also realizes a margin, corresponding to the difference between the selling rate and the buying rate of the currency (i.e., the "spread").

- *The commission charged to the customers is subject to VAT at the standard rate of 5%*
- *The margin realized on the spread for each service is VAT exempt*

Example 2

A bank, established and registered for VAT in Bahrain, finances the acquisition of a Bahrain real estate property by a private individual resident in Bahrain.

For its financing service, the bank will charge its customer a capped interest rate (to be applied on the re-payable principal amount) as well as an arrangement fee (payable upfront for the arrangement of the financing).

- *The arrangement fee charged to the customer is subject to VAT at the standard rate of 5%*
- *The capped interest rate applicable on the re-payable principal amount is VAT exempt*

There are also prescribed financial operations that are exempt from VAT in Bahrain, irrespective of the form of consideration received (i.e., fee or margin). For the following operations, the exemption applies regardless of the form of consideration in any case:

- The issue, allotment, or transfer of ownership of an equity security or debt security
- The execution of life insurance and reinsurance contracts, and the transfer of such contracts

For the transactions listed above, the exemption is solely linked to their “financial” nature and the remuneration by way of interest or margin is not a condition for the VAT exemption to apply.

4.1.3. Islamic finance

For the purpose of applying the financial services VAT exemption, Islamic finance products which simulate the intention and achieve effectively the same result as a non-Shari’ah compliant financial product are treated in a similar manner as the equivalent non-Shari’ah financial products.

Further details on the VAT treatment of Islamic Finance products are provided in this Guide in section 5.7.

4.1.4. Export of financial services

Financial services supplied by a taxable person resident in Bahrain that meet the conditions to qualify as exported services will be subject to VAT at the zero-rate (see the Imports and Exports VAT Guide for further detail on exported services).

VAT in Bahrain at the zero-rate will prevail over the application of both a VAT exemption and VAT at the standard rate. Therefore, a financial service that would otherwise be exempt from VAT will be subject to VAT at the zero-rate when it meets to conditions to be treated as an exported service. The same applies to a financial service that would otherwise be subject to VAT at the standard rate.

Taxable persons who export financial services are therefore not charging an actual amount of VAT on their services but are entitled to recover VAT charged on the expenses they incurred for providing these services.

Example 1

Fuad, an individual having its place of residence in the UK, uses the services of a broker established and registered for VAT in Bahrain to acquire stocks of a company listed on Bahrain Bourse. The broker receives the order via his brokerage platform and charges a commission to Fuad for his brokerage / execution services.

- *The place of supply of the broker's services is in Bahrain, which is the place of residence of the supplier*
- *The services are supplied to a customer who has no place of residence in Bahrain or in any Implementing State and which was not present at the time of the supply*
- *These services do not relate to moveable goods or a real estate located in Bahrain or in any other Implementing State at the time of the supply*
- *The customer does not "enjoy" the services in Bahrain or in any other Implementing State*

Consequently the brokerage services should qualify as "exported" services and the commission charged for these services should be subject to VAT at the zero-rate.

The zero-rate treatment prevails over the application of the standard rate of 5%, which would have been applicable if the services did not qualify as "exported" services.

Example 2

A Bahrain based private equity fund, registered for VAT, sells its equity stakes (i.e., shares) in a South African company to an investor established in South Africa.

This sale of shares is a supply of services from the Bahrain based private equity fund to the purchaser of the shares in South Africa.

- *The place of supply of the services is in Bahrain, which is the place of residence of the seller*
- *The services are supplied to a customer who has no place of residence in Bahrain or in any Implementing State and which was not present at the time of the supply*
- *These services do not relate to moveable goods or a real estate located in Bahrain or in any other Implementing State at the time of the supply*
- *The customer does not "enjoy" the services in Bahrain or in any other Implementing State*

Consequently the sale of the shares should qualify as "exported" services and should be subject to VAT at the zero-rate.

The zero-rate treatment prevails over the application of the VAT exemption, which would have been applicable if the services did not qualify as "exported" services.

4.1.5. Zero-rating of precious metals

The supply of gold, silver and platinum is zero-rated in either of the following cases:

- The first supply after extraction when this supply is carried out for trading purposes, i.e., purchased by a person who intends to use the metal for business purposes, such as to purify it, use it in a manufacturing process, etc.
- The supply of investment gold, silver or platinum.

Investment gold, silver and platinum are metals with a purity of at least 99%, which are tradable on global bullion markets and which are certified by the Ministry of Industry, Commerce and Tourism (MoICT) or an entity licensed by the MoICT.

The supply of metals which do not qualify under one of the two cases above will be subject to VAT at the standard rate of 5% unless it falls under another specific zero-rating regime (e.g., zero-rated export of goods).

5. VAT treatment of specific financial services

This section will provide you with the necessary guidance regarding the VAT treatment applicable to the main financial services when supplied in Bahrain by a taxable person.

For further information regarding the rules to determine the place of supply and the tax due date of the services, please see Appendix A and Appendix B of this Guide.

The below is general guidance based on the general and most common understanding of these financial services. It is recommended that you assess and determine at all times the correct VAT treatment of your services based on the specific terms and conditions of your contracts, as these may differ from the generic services covered in this Guide.

5.1. Money related services

5.1.1. Operation of bank accounts

Overview of products / services

These are services typically performed by banks and similar organisations in connection with the operation of current, deposit or savings accounts.

Services of operating bank accounts might notably include the following:

- Provision of debit cards
- Provision of cheque books
- Provision of statements and duplicate statements
- Charges for dishonoured cheques
- Transfers between accounts
- Processing direct debit and standing orders
- Issuing of certificates of balance
- Issuing of audit certificates
- Provision of special cheques (e.g., manager’s cheques)
- Access to e-banking

VAT treatment

In principle, services of operating bank accounts follow the general place of supply rules applicable to services.

Operation of bank account services, when performed for consideration, are generally supplied for the payment of a fee or fee(s). Therefore, when supplied in Bahrain, they are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Banks may charge a single fee for the operation of a bank account to cover a broad range of services. This fee and the services it covers would most likely meet the features to qualify as a single composite supply for VAT (see Appendix D of this Guide for further detail on single composite supplies and multiple supplies). This supply would also most likely qualify as a continuous supply of services for the purposes of the tax due date rules.

There are some services that banks may only provide upon request and for which a specific fee per request is charged (e.g., provision of a special cheque, issue of a certificate). In principle these “on-demand” services should be considered as separate supplies of services and would most likely qualify as one-off supplies of services for the purposes of the tax due date rules.

In any case, it is recommended that banks and financial institutions determine the correct VAT treatment of their respective services based on the specific terms and conditions applicable under the contracts with their customers.

VAT treatment of interest earned on bank deposits

Interest income earned by a non-taxable person on his bank deposits is outside the scope of VAT.

Interest income earned by a taxable person on his bank deposits is generally considered outside the scope of VAT (as opposed to VAT exempt). This is because the taxable person does not perform any specific supply in exchange for the interest paid by the bank. This income is earned in a passive manner.

Notwithstanding the above, the VAT treatment would be different and the interest income would be considered as a VAT exempt income when the taxable person actively sought the realization of this income by, for instance, negotiating special interest rates for his deposits or if the interest income is the result of a cash pooling activity (whether involving actual transfer of the money or on a notional basis).

Finally, when the taxable person earning interest income on deposits is a bank or a financial institution, its interest income falls by default within the scope of VAT and is treated as VAT exempt (or subject to VAT at the zero-rate in case of export of services).

5.1.2. Transfer of money and related services

The transfer of money is a service consisting of the execution of an order for the transfer of a sum of money.

Banks and other financial institutions usually offer money transfer services (local and international) and may charge a fee or commission in consideration for the services. The most common charges usually associated with transfer of money are transfer or remittance fees and correspondent bank charges.

5.1.2.1. Transfer of money and remittances

Overview of products / services

Transfer of money and remittance services consist of executing, upon receipt of an order, the transfer of a given amount of money to a named beneficiary, either locally or internationally.

VAT treatment

Transfer / remittance services follow the general place of supply rules applicable to services.

When supplied in Bahrain, transfer and remittance services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Transfer / remittance services should, in principle, qualify as one-off supplies of services for the purposes of the tax due date rules.

The way the money will be “moved” (e.g., wire transfer, on-line transfer, use of credit or debit cards, cash) and the reason triggering the transfer instruction (e.g., payment to a third party, gift or transfer of own savings) do not impact the nature of the transfer / remittance services and their VAT treatment as explained above.

The cost of the transfer / remittance services can be borne either by the transferor / remitter or by the beneficiary of the transfer or they can be shared between the two of them. It is important to keep in mind that the person bearing the cost of the transfer / remittance services is not necessarily the “recipient” of the services for the purposes of VAT.

From a VAT perspective, it is critical to identify the actual recipient of the services based on the agreement supporting the provision of the transfer services, the person from whom the supplier receives the transfer instruction and to whom it is liable for the proper execution of the services. The person paying for the service is usually the least relevant criteria to be used to identify the recipient of a service. This is because payment may be made by a third party (i.e., a person that is not the recipient of services).

For money transfer services, it is generally expected that, for VAT purposes, the recipient is the person who seeks the transfer of his funds, i.e., the transferor / remitter, irrespective of the person actually incurring the transfer / remittance related costs.

Example

An individual having its place of residence in Bahrain wants to send money to his family living in his home country.

- *The individual (i.e., the instructor) instructs his bank in Bahrain to proceed with the transfer of BHD 250 onto the foreign bank account of his parents (i.e., the beneficiaries).*
- *The banks will charge a transfer / remittance fee for executing the transfer.*
- *This fee can be incurred either by the instructor (the bank will transfer BHD 250 and ask the instructor for an additional payment for the fee) or by the beneficiaries (the bank will withdraw its fee from the BHD 250 before transferring the remaining amount).*

The recipient of the bank's transfer services is the instructor. This is irrespective of the fact that the bank's fee can be borne either by the instructor or by the beneficiaries.

5.1.2.2. Correspondent bank charges

Overview of products / services

When a local bank is instructed to transfer money to a foreign bank account, it may use a correspondent bank in that country that will make the money transfer on its behalf (via the use of nostro / vostro accounts). The correspondent bank will usually charge a fee for the transfer carried out for the local bank.

VAT treatment

Correspondent bank services follow the general place of supply rules applicable to services.

When supplied in Bahrain, correspondent bank services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Whether correspondent bank services qualify as one-off supplies or continuous supplies of services will depend on the terms and conditions of the service agreement entered into with the correspondent bank.

Correspondent bank services invoiced by Bahrain resident banks when acting as correspondent banks for foreign banks are subject to VAT in Bahrain at the zero-rate if the conditions for the services to qualify as exported services are met. Where the conditions are not met, such charges are subject to VAT at the standard rate of 5%.

In order to apply the correct VAT treatment to their correspondent bank services (i.e., 5% or 0%), resident banks in Bahrain must identify the recipient of their services (e.g., whether the recipient of the services is the foreign bank, the transferor / remitter or the beneficiary).

Correspondent bank services invoiced by foreign banks when acting as correspondent banks for Bahrain resident banks are, in principle, subject to VAT in Bahrain at the rate of 5% under the reverse-charge mechanism, when the Bahrain resident banks are taxable persons. The Bahrain resident banks are therefore expected to self-account for VAT in Bahrain at the rate

of 5% on the charges made by a foreign correspondent. This VAT should be recoverable when the Bahrain resident banks use these expenses for the purpose of supplying taxable services (e.g., international transfer services).

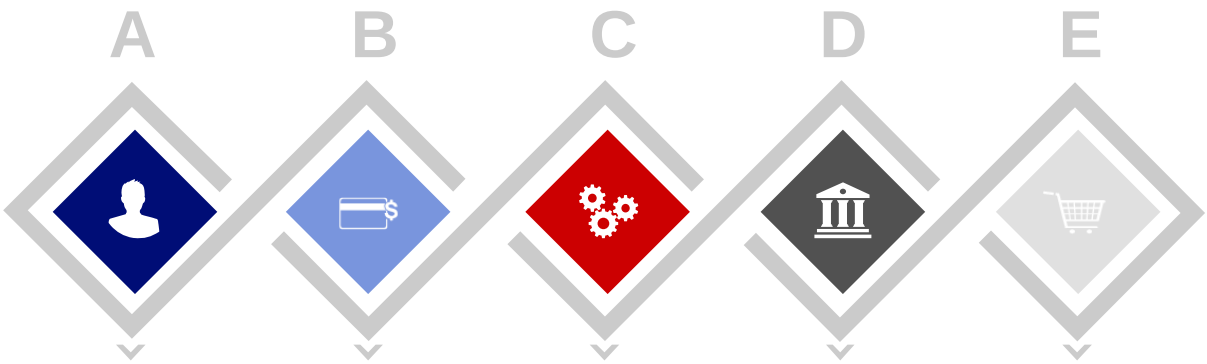
The above treatment is based on the assumption that the Bahrain resident banks contract with the foreign correspondent banks in their own name and act as principal when supplying and receiving the services to / from their correspondent banks. Please see Appendix C of this Guide for further detail on disclosed and undisclosed agents.

It is recommended that Bahrain resident banks review the terms and conditions of their contracts with their foreign correspondent banks and their clients in order to identify whether they act in their own name or in the name of their clients when dealing with foreign correspondent banks.

5.1.3. Payment related services

This section focuses on payment related services specific to the use of cards (i.e., debit or credit cards) as means of payment, as well as the main factors generally involved in payment related services.

Figure 3: Key actors in payment related services



CARDHOLDER

Individuals and corporates who obtain a card from an issuing bank to make payments to merchants for goods or services

ISSUER

Banks and financial institutions issuing debit and credit cards to their customers

PAYMENT NETWORK OPERATORS

Businesses providing infrastructure process for payments made with cards. Examples of networks are Visa and Mastercard

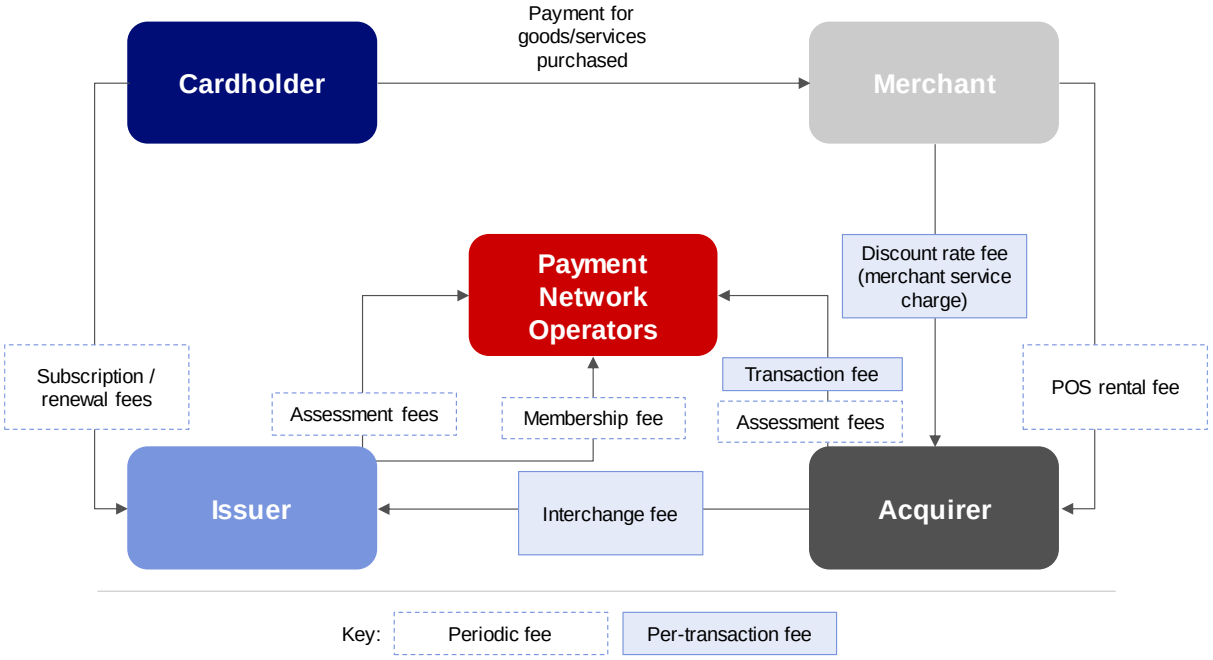
ACQUIRER

Banks and financial institutions offering merchants the capabilities to accept payments through debit and credit cards

MERCHANT

Businesses accepting card payments for the goods or services they are selling

Figure 4: Typical fees for payment related services



5.1.3.1. Payment Network Operators

Overview of products / services

Their main services usually consist in granting banks and other financial operators access / membership to their respective network as well as running the platform facilitating the payment transactions between the card issuer members and the acquirer members.

VAT Treatment

In principle, services supplied by payment network operators follow the general place of supply rules applicable to services.

When supplied by a payment network operator resident in Bahrain, these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

When such services are supplied by non-resident operators to members which are taxable persons resident in Bahrain (e.g., issuers and acquirers), these members are expected to account for 5% VAT under the reverse charge mechanism. This VAT can be recovered if it is used by the members for making taxable supplies.

Membership fees charged by card scheme operators to their members should qualify as consideration for a continuous supply of services (i.e., joining the network as a member) for the purposes of the tax due date rules.

Assessment fees, which usually correspond to a periodic commission per volume of transactions processed, should qualify as the consideration for a continuous supply of services (i.e., administration of the scheme) for the purposes of tax due date rules.

The processing fee, usually charged to the Acquirer in the form of a flat fee per transaction processed, should qualify as the consideration for a one-off supply of services (i.e., processing of a specific payment transaction) for the purposes of tax due date rules.

It is critical for issuers and acquirers to look at their existing arrangements with the respective payment network operators so as to determine the relevant tax due date rules applicable to the various services and fees covered under these arrangements.

Table 3: Treatment of services supplied by Payment Network Operators

Fee and services	Recipient	VAT treatment in Bahrain	Tax due date rules
Membership fee (joining network)	Issuer / Acquirer	Taxable	Continuous supply
Assessment fee (administration)	Issuer / Acquirer	Taxable	Continuous supply
Processing fees (processing a given transaction)	Issuer / Acquirer	Taxable	One-off supply[1]

5.1.3.2. Issuers

Overview of products / services

Issuers are banks and financial institutions issuing debit and credit cards to their customers (the cardholders). Issuers usually provide two types of services: the issue of the payment card to the cardholder and the interchange services to the acquirer.

a) Card issuing services

Upon certain conditions being met, issuers will grant their customers a credit or debit card for a set period of time. The issuers will usually charge a subscription or a renewal fee to the customers in exchange for the issue of the payment cards.

1 One-off supply unless it is structured differently under the arrangement in place. To be assessed on a case by case basis

VAT Treatment

In principle, cards issuance services follow the general place of supply rules applicable to services.

When supplied in Bahrain, subscription fees charged by the card issuer for the issue or renewal of a payment card are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Card issue and renewal services should qualify as continuous supplies of services to the extent they consist of granting card holders the right to use their cards as means of payment for a given period of time.

Issuers may also earn other income triggered by the use of the cards issued, such as interest on outstanding balances. The VAT treatment of other income generated by payment cards is covered in the relevant sections of this Guide.

b) Interchange services

Issuers are entitled to receive an interchange fee for each payment carried out using one of the cards issued by them.

Although the level of fee to which the card issuer is entitled is determined by the payment network operator, the fee is actually earned by the issuer in exchange for his services to the acquirer.

The issuer is entitled to receive this fee in exchange for proceeding with the payment of the amount due by the cardholder to the acquirer / merchant and is meant to cover the issuer's costs and risks linked to this payment (e.g., approving the sale, risk of fraud, handling costs, etc.).

Therefore, from a VAT perspective, the recipient of the interchange services supplied by the issuer is the acquirer.

VAT Treatment

In principle, interchange services supplied by issuers follow the general place of supply rules applicable to services.

When supplied in Bahrain, the interchange fee charged by issuers are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Interchange fees levied per transaction processed should qualify as one-off supplies of services.

Table 4: Treatment of services supplied by Issuers

Fee and services	Recipient	VAT treatment in Bahrain	Tax due date rules
Subscription / Renewal fee (card issuance)	Cardholder	Taxable	Continuous supply
Interchange fee (payment processing)	Acquirer	Taxable	One-off supply

5.1.3.3. Acquirers

Overview of products / services

The acquirer is the bank or financial institution offering merchants the facilities required to accept payments by means of debit / credit cards, including the maintenance of a merchant account.

VAT treatment

Acquirers will usually provide various services to the merchants. We have listed below the most common services and fees levied by acquirers.

a) Merchant service charge

Merchant service usually refers to the service of processing a card payment transaction. It is supplied by the acquirer to the merchant.

The acquirer usually charges a fee per card payment transaction processed. This fee usually recoups, among other things, the interchange fee charged by the card issuer to the acquirer (i.e., the acquirer usually passes on the cost of the interchange services to the merchant) to which a mark-up is usually added.

This fee usually takes the form of a “discount” and is labelled “discount rate”; i.e., the acquirer deducts his fee from the amount he has to pay to the merchant. In these circumstances, the consideration for the service provided by the acquirer to the merchant is the difference between the full amount owed by the acquirer to the merchant and the actual amount received by the merchant from the acquirer.

In principle, such services follow the general place of supply rules applicable to services.

When supplied in Bahrain, these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Merchant services supplied on a per transaction basis should qualify as one-off supplies of services.

b) Rental of point-of-sale devices

The acquirer will usually charge a fee to the merchant for the rental of the devices they use to place the cardholders' cards into and transmit the details to the acquirer for authorization (e.g., chip and pin terminals).

In principle, such services follow the general place of supply rules applicable to services.

When supplied in Bahrain, they are subject to VAT at the standard rate of 5%. It is not expected that such services could qualify as zero-rated exported services when the rented terminals are located in Bahrain.

Point-of-sale rental services should qualify as continuous supplies of services.

c) Payment gateway fee

Payment gateway services generally consist of providing the merchants with an "online terminal" that is used to authorize on-line card payments. The gateway collects the payment details from the card presented to the merchant for online payment and passes these details to the acquirer.

These services are often outsourced by acquirers to providers of electronic services.

Such services, depending in their exact features, may qualify as electronically supplied services and follow the special place of supply rules applicable to electronic services.

When supplied in Bahrain, they are subject to VAT at the standard rate of 5%.

Whether payment gateway services qualify as one-off supplies of services or continuous supplies of services will depend on the exact terms and conditions and fee structure governing the services.

d) Joining or set up fees

Acquirers may charge a joining or set up fee to any new merchant contracting with them.

In principle, such services follow the general place of supply rules applicable to services.

When supplied in Bahrain they are subject to VAT at the standard rate of 5% unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Whether such services qualify as one-off supplies of services or continuous supplies of services will depend on the exact scope of the services covered by the fees and the terms and conditions applicable to them.

e) Other administration fees

Acquirers may also charge merchants other administration fees such as a minimum monthly charge (i.e., minimum charge for processing the merchants' card transactions), an annual administration charge (i.e., to cover the costs incurred by the acquirer for maintaining the merchant's account), an authorization fee (i.e., a specific fee for authorizing each transaction), a chargeback fee (i.e., a specific fee for reverse processing where a merchant has to return the money to his customer's account).

In principle, such services follow the general place of supply rules applicable to services.

When supplied in Bahrain they are subject to VAT at the standard rate of 5% unless the conditions to apply the zero-rate (for export of services) are met.

Whether such services qualify as one-off supplies of services or continuous supplies of services will depend on the exact scope of the services covered by the fees and the terms and conditions applicable to them.

Table 5: Treatment of services supplied by acquirers

Fee and services	Recipient	VAT treatment in Bahrain	Tax due date rules
Discount rate fee (merchant service / processing)	Merchant	Taxable	One-off supply
Point-of-sale rental fee (rental services)	Merchant	Taxable	Continuous supply
Payment gateway fee (provision of an electronic terminal)	Merchant Acquirer (when outsourced)	Taxable	Continuous / one-off supply
Joining / set up fee (joining / setting up the merchant account)	Merchant	Taxable	Continuous / one-off supply
Administration fees (various administration services)	Merchant	Taxable	Continuous / one-off supply

5.1.3.4. Loyalty schemes associated with payment cards

Most credit cards are enrolled in loyalty schemes that are structured with a view to increase spending on these cards and maintain customer loyalty. Purchases made using the credit card are linked to a reward by issuing points.

Loyalty points and rewards may be provided by the supplier directly (e.g., the card issuer) or by a third party operating a loyalty and reward scheme with whom the supplier has enrolled.

Very often, loyalty points will be issued as a result of spending with a member of the scheme and can be redeemed with another member.

Further guidance on VAT implications of loyalty schemes will be issued in due course.

5.1.4. Foreign exchange

Foreign exchange activities can be broken down into two categories:

- Currency exchange services
- Foreign currency trading

The main services provided and their VAT treatment is described below.

5.1.4.1. Currency exchange services

Overview of products / services

These services are usually offered by banks, foreign exchange companies or bureaux de change, and enable customers to convert an amount owned in a given currency into another currency.

In consideration for their currency exchange services, these service providers may charge a fee or commission (generally based on a pre-agreed charging scale) and may also earn a profit resulting from the difference between the bid rate and the sell rate ("spread").

VAT Treatment

In principle, currency exchange services follow the general place of supply rules applicable to services.

When supplied in Bahrain for payment of a fee or commission, such services are subject to VAT at the standard rate of 5% unless the conditions to apply the zero-rate of VAT (for export of services) are met.

When supplied in Bahrain with the realization of a spread, such services are exempt from VAT unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Such services would generally be regarded as one-off supplies of services for the purposes of the tax due date rules.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide for further detail).

Taxable persons are required to issue tax invoices for the taxable fee or commission charged in consideration for their exchange services.

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices provided they are able, upon request of the NBR, to electronically extract and provide the details of their VAT exempt financial services income. NBR auditors may still audit records through any other means.

Example
An individual lands in Bahrain and wants to exchange Euro currency for Bahraini Dinars (in cash). He goes to a bureau de change located in the arrival area of the airport to proceed with the exchange. The bureau de change is registered for VAT. *The bureau de change informs the customer that a commission of 1.5% of the converted amount will be charged for the currency exchange service.* *The bureau de change also realizes a margin on this transaction based on the bid-ask rate spread. The bureau de change will charge Bahrain VAT at the standard rate of 5% on the commission and will have to issue a valid tax invoice for this commission.* *The margin realized will be VAT exempt and the Bureau de change will not be required to issue a valid tax invoice for this margin. Nonetheless, the Bureau de change will have to make sure that it is able to electronically extract and provide, upon request of the NBR, the details of this VAT exempt income.*

Input tax recovery position

For the purposes of input tax recovery and the computation of the residual input tax apportionment ratio under the standard method (see section 9.6 of this Guide), the values to be taken into account are the following:

- All the fees and commissions charged for the foreign exchange services
- The net result of the currency buy-and-sell transactions realized during the tax period

Sale of numismatic and commemorative money

The sale of commemorative money or money used as a collector's item, which is not intended for use as legal tender, is considered as a supply of goods. It is subject to VAT at the standard rate of 5% when supplied in Bahrain.

5.1.4.2. Foreign currency trading

Overview of products / services

Trading is when a person, for his own account, actively enters into foreign currency buy-and-sale transactions (spot or forward) with the aim of generating a profit.

The spread realized is the result of an active trading of currencies with the intention to take a spread position over a period of time.

Taxable persons entering into speculative foreign currency trading, whether proprietary or in support of other areas of their business are considered as making supplies of services.

VAT Treatment

In principle, foreign currency trading supplies follow the general place of supply rules applicable to services.

When supplied in Bahrain with realization of a spread, such services are exempt from VAT unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Such services would generally be regarded as one-off supplies of services for the purposes of the tax due date rules.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide).

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices provided they are able, upon request of the NBR, to electronically extract and provide details of their VAT exempt financial services income. The NBR auditors may still audit records through any other means.

Input tax recovery position

For the purposes of input tax recovery and the computation of the residual input tax apportionment ratio under the standard method (see section 9.6 of this Guide), the value to be taken into account is the net result of the currency buy-and-sell transactions realized during the tax period

Cases where foreign exchange transactions are not supplies for VAT purposes

There are instances where a taxable person conducts foreign exchange transactions but such transactions will not be treated as supplies of services and the income generated will be outside the scope of VAT.

This is generally the case where a taxable person does not actively seek to make a profit out of these foreign exchange transactions, for example:

- A business exchanging one currency for another to convert foreign earnings into local currency or to acquire currency to settle liabilities incurred outside Bahrain
- A business entering into forward forex deals in order to limit its exposure to forex fluctuations in respect of future obligations

On the other hand, any businesses with a corporate treasury operation active in financial markets would likely be considered as seeking the realization of a profit and would therefore be considered as making foreign exchange supplies of services falling within the scope of VAT. This is not only valid for businesses in the financial services sector but also for any businesses irrespective of their industry or sector.

Example

A construction company, taxable person resident in Bahrain, has a treasury function which is notably in charge of placing the company's funds surplus so as to generate additional income. The treasury department uses some of the funds to trade in foreign exchange currencies with the intention to realize margins.

The construction company is here actively seeking the realization of an income (by way of spread) by entering into foreign exchange currencies trades. It is thus performing a trading activity that falls within the scope of VAT and the income generated as a result of this activity (i.e., margin) must be treated as a VAT exempt income.

Retail Forex Brokers

Traders in foreign exchange currencies, especially "retail" ones, usually need a forex broker in order to conduct their foreign exchange currency trades.

Retail forex brokers usually allow traders to set up an account with a limited amount of funds and let them trade online through internet-based trading platforms.

Some brokers will act as broker-dealers (i.e., they are the trader's counterpart), some brokers will act as non-dealers (they simply act as intermediary between the trader and his counterpart). The former are usually remunerated by way of a margin (i.e., the spread on bid-ask rates), the latter by way of a fee or a commission.

The services provided by these brokers are not different in nature from the more "traditional" currency exchange services (i.e., bureaux de change, foreign exchange desks, etc.) and follow the same VAT treatment as the one detailed in section 5.1.4.1 of this Guide.

Intermediary services

Some traders, (e.g., institutional investors or high net worth individuals), will delegate their trading decisions to persons who will trade in their name and on their behalf (e.g., the asset manager of a collective investment scheme will trade in the name and on behalf of the scheme).

These persons, acting in the name and on behalf of the principal traders, are solely acting as "intermediaries" / "disclosed agents" and are not considered as conducting the trading activity themselves. The trading activity is still considered conducted, and the income resulting from it realized by, the actual traders (i.e., the person in the name and on behalf of whom the agent is trading).

The intermediaries are actually supplying an intermediary / agency service to the actual traders. They may provide this service either for payment of specific consideration (generally in the form of a fee or commission) or as part of a broader asset management mandate, usually remunerated by way of a management fee.

In all cases, these intermediary / agency services follow the general place of supply rules applicable to services.

When supplied in Bahrain for payment of a fee or commission, such services are subject to VAT at the standard rate of 5% unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Depending on the terms of the contract entered into between the trader and his intermediary, such services may be considered either one-off supplies of services or continuous supplies of services for the purposes of the tax due date rules.

5.1.5. Financial guarantees and security for money

Overview of products / services

A financial guarantee is a promise by a guarantor to take responsibility for another person's financial obligation if that person cannot meet his obligation.

Only financial guarantees over financial obligations arising under cheques, credit securities, debt securities, or similar instruments will be regarded as financial services. Performance guarantees, as well as warranty contracts, will not be regarded as financial services.

A security for money is defined as a covenant, promise or undertaking to pay a sum of money usually evidenced by a document or a legal agreement. For example, bills of exchange, bank drafts, travellers' cheques and letters of credit are securities for money. Stocks, shares, bonds, etc. are not securities for money.

A letter of credit is an obligation by a bank to make a payment once certain terms and conditions are met. Once these terms and conditions are completed and confirmed, the bank will transfer the funds.

The issue of a security for money and the provision of a financial guarantee are considered as financial services when they are issued / provided by a taxable person for consideration.

The issue of a security for money or the provision of financial guarantee will usually be subject to certain fees or commissions such as a guarantee fee, issuance fee, advising fee, confirmation fee, handling charges, etc.

VAT treatment

In principle, such services follow the general place of supply rules applicable to services.

Therefore, when supplied in Bahrain they are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Depending on the terms and conditions of the contract and the features of the services supplied, the supply may be either a one-off supply of services or a continuous supply of services. It is critical to look at the contract so as to determine the relevant tax due date rules applicable to the services.

It may be that a credit or financing element is attached to the security for money issued and triggers the charging of interest or the realization of an implicit margin. When it is the case, this interest will follow the VAT treatment applicable to credit and financing services (see section 5.2.1.1 of this Guide) and will therefore be VAT exempt unless it qualifies for zero-rating (when it constitutes an export of services).

Guarantee, letters of credits and other securities for money usually involve several parties (e.g., the applicant, the beneficiary, the guarantor, the issuing bank, the advising bank, the negotiating bank, the confirming bank etc.). When supplying a service under one of these multiple-party arrangements, it is critical to identify the actual recipient of the service, as this will have an impact on the VAT treatment applicable (specially to assess whether VAT is chargeable at the zero-rate).

In this respect, the party to whom the payment is promised (i.e., the beneficiary) is not necessarily the recipient of the services for VAT purposes. For instance, in a letter of credit, the recipient of the issuing bank's services is generally the applicant (even if the letter of credit is issued to the beneficiary).

Also, the party designated to bear the cost of a service is not necessarily the actual recipient of this service for VAT purposes. This person might solely be the paying party while the service is actually supplied to another party. For instance, the fee charged by the advising bank to notify the beneficiary that a letter of credit is available may be borne by the beneficiary (when designated as the paying party for this fee) but the notification service is actually supplied to the issuing bank (which requested this notification as part of the issuing of the letter of credit).

5.1.6. Automated Teller Machines (ATMs)

Overview of products / services and VAT treatment

Fees charged to ATM users

In Bahrain, the use of ATMs to perform a banking operation (e.g., cash withdrawal using a debit card, mini-statements, cash deposit etc.) is not subject to any fee charged by the banks / ATM operator to the customers.

Fees may be charged when a credit card or a pre-payment card is used to withdraw money from an ATM, depending on the fee policy applicable to the specific credit / pre-paid card used (as decided by the card issuer / card operator). In principle, such services follow the general place of supply rules applicable to services. Therefore, when supplied in Bahrain, they are subject to VAT at the standard rate of 5%. These services would generally be one-off supplies of services for the purposes of the tax due date rules.

Interchange fees

Interchange fees are charges between banks when their customers use other banks' ATM facilities. They are usually levied on a transaction-by-transaction basis.

The usage of other banks' ATM facilities, for which interchange fees are charged, are regarded as financial services.

In principle, such services follow the general place of supply rules applicable to services.

Therefore, when supplied in Bahrain they are subject to VAT at the standard rate of 5% unless the conditions to apply the zero-rate of VAT (for export of services) are met.

These services would generally be one-off supplies of services for the purposes of the tax due date rules.

Provision of an ATM and software

Supplies of an ATM itself or of the software required to run it are not financial services and are subject to VAT at the standard rate of 5% when supplied in Bahrain.

Services carried out on ATMs

Services provided in connection with the routine operation of an ATM, including filling with cash, maintenance and repair, are not financial services and are subject to VAT at the standard rate of 5% when supplied in Bahrain.

Site rental

The granting of a right to permanently attach an ATM to the ground, or for its incorporation into the fabric of a building, is not a financial service but a land related service.

In accordance with the place of supply rule applicable to services related to land, a site rental service is supplied in Bahrain when the site is in Bahrain.

When supplied in Bahrain, such a service is exempt under the VAT exemption applicable to the sale and rent of real estate.

5.1.7. Safe custody

Safe custody is the provision of a physical service of safekeeping (i.e., service of a secured storage, rental of a safe-deposit box). It is usually remunerated by way of a rental fee.

These services are subject to VAT at the standard rate of 5% when supplied in Bahrain.

5.2. Credit and financing services

5.2.1. Credit and lending activity

5.2.1.1. Granting of loans, line of credit, overdraft

Overview of products / services

Conventional banks and financial institutions usually offer credit and financing services to their customers consisting of lending or advancing money in consideration for the payment of interest.

In these financing arrangements, a bank (“lender”) advances or puts an amount of money at the disposal of his customer (“borrower”) that the latter must then repay, together with the interest applicable, according to the conditions agreed in the financing or credit contract.

Fees associated with the granting of financing can also be charged as part of the financing arrangement (e.g., commitment fee, application fee, administration fee, etc.).

Personal and cash loans, overdrafts, credit cards outstanding balances and mortgages usually fall within this category of financing arrangements.

VAT Treatment

The supply of interest-bearing finance and credit services is a financial service.

Such services, when provided by taxable persons other than banks or financial institutions, are financial services for the purposes of VAT and are subject to the same VAT treatment.

In principle, such services follow the general place of supply rules applicable to services.

Granting of financing

When supplied in Bahrain interest-bearing financing services are VAT, exempt unless the conditions to apply the zero-rate of VAT (for export of services) are met. The VAT exemption is applicable since these financial services are remunerated by way of interest.

Financing and credit services are usually continuous supplies of services for the purpose of tax due date rules.

Services associated with the grant of financing

When supplied in Bahrain, they are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Whether these services are one-off supplies of services or continuous supplies of services for the purposes of tax due date rules will depend on their exact nature. The fact that the fees may be amortized for accounting purposes does not necessarily impact whether the services are one-off or continuous supplies of services from a VAT perspective.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide for further detail).

Taxable persons are required to issue tax invoices for taxable fees or commissions charged in consideration for their services associated with the grant of financing.

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices provided they are able, upon request of the NBR, to electronically extract and provide the details of their VAT exempt financial services income. NBR auditors may still audit records through any other means.

Input tax recovery

The repayment of the amount loaned is outside the scope of VAT. The amount loaned is the service actually supplied and it is therefore not part of the consideration received by the lender for his financing services.

The repayment of the amount loaned must not be taken into account when computing the lender's input VAT recovery apportionment ratio. Under the standard method only the interest income and the fees for the services associated with the grant of financing must be included in the computation of the input VAT recovery apportionment ratio (see section 9.6 of this Guide for further detail).

Example

A bank (taxable person resident in Bahrain) agrees to lend a specified amount of money to a start-up business in Bahrain ("borrower").

The bank agrees to lend the money at a fixed interest rate and the borrower must refund the principal amount, together with the amount of interest, in 24 months. The bank also charged an arrangement fee to the borrower for the preparation of the financing file.

The bank will be required to charge Bahrain VAT at the standard rate of 5% on its arrangement fee and to issue a valid tax invoice. This service should be considered as a one-off supply of services for the application of the tax due date rules.

The interest income charged by the bank will be VAT exempt and the bank will not be required to issue valid tax invoices. It will have to make sure that it is able to electronically extract and provide, upon request of the NBR, the details of this VAT exempt income. The financing service should be considered as a continuous supply of services for the application of the tax due date rules. Regarding the computation of the bank's input tax recovery ratio under the standard method of apportionment, the bank will have to include the following:

- *The value of the arrangement fee (taxable)*
- *The value of the interest income (exempt)*

5.2.1.2. Secured loans

Overview of products / services

Secured loans are financing arrangements which are secured by collateral in order to reduce the risk associated with lending.

Under a secured loan, the lender provides financing in consideration for interest (in the same way as an unsecured loan) and may also charge for additional services related to the financing. The VAT treatment of the financing services and related services under a secured loan is the same as under a non-secured loan (see section 5.2.1.1 of this Guide for further detail).

The section below focuses on the features of a secured loan and the VAT treatment applicable.

VAT treatment

Granting of collateral by the borrower

Collateral is an asset that the borrower gives to a lender as security. If the borrower is in default on the loan, the lender can seize the collateral, sell it and use the proceeds to pay back the loan.

In a secured loan, the borrower grants the lender the right (the "security") to sell a specified asset (the "collateral") if the borrower fails to meet the obligations of the loan or credit contract.

An example of secured loan is a mortgage loan, where the collateral is the property the acquisition of which is being financed. Pledge, hypothecation and lien are other forms of security mechanisms for secured loans.

The granting of collateral, as a security for a loan, by the borrower to the lender is not a supply for VAT purposes. It is therefore disregarded for VAT purposes.

Example

A private individual resident in Bahrain wants to acquire a real estate property located in Bahrain. A bank, taxable person resident in Bahrain, agrees to lend that individual (the "borrower") the sum he needs to acquire the property (i.e., 80% of the property selling price) on the condition that the property is mortgaged.

The borrower will therefore purchase the property and, upon purchase, will grant the bank the right to sell it if he cannot meet his repayment obligation under the financing arrangement (i.e., the property is the collateral).

The acquisition of the property happens directly between the seller and the borrower. Whether this transaction is a supply of goods falling in the scope of VAT will depend on the VAT status of the seller (i.e., whether the seller is a taxable person which acts in this capacity when selling the property). The grant, by the borrower to the bank, of the right to sell the property is not a supply for VAT purposes. This grant does not trigger any VAT event.*

**This remains applicable even in case where the borrower is a taxable person and the collateral given to the bank are his newly acquired offices.*

Seizure and sale of the collateral by the lender

If the borrower defaults, the lender is entitled to seize the collateralized asset and sell it.

Except where the lender takes the full legal ownership (i.e., the right to possess and dispose of the asset), the lender will sell the asset in the name and on behalf of the borrower. It will use the sale proceeds to repay the loan (and will transfer the remaining amount to the borrower, if any amount is left after applying the proceeds of sale towards the loan).

In this case, the lender is not making any supply of goods or services when selling the collateral. It is solely acting as a disclosed agent, selling the collateral in the name and on behalf of the borrower (see Appendix C for further details on disclosed agents). This sale of the collateral is therefore not a supply for VAT purposes by the lender. However, it may constitute a taxable supply of goods or services by the borrower (where the borrower is a taxable person and acts in this capacity when selling the asset).

Costs that the lender may pay, in the name and on behalf of the borrower, as part of the seizure and sale of the collateral should, in principle, be considered as disbursements. The

recovery of such costs by the lender from the borrower would not be a supply by the lender to the borrower. The lender is expected to pay the suppliers the amounts charged by them and to recover the same amounts from the borrower. When any VAT is charged by the suppliers, the lender cannot treat this VAT as his input tax and is not entitled to recover it in its tax return.

Example

The borrower, in our previous example, is in default and the bank decides to seize and sell the property so as to be paid for the outstanding amount due by the borrower.

The bank seizes the property (but does not acquire the ownership) and sells it on behalf of the borrower. It then uses the selling proceeds to repay the borrower's outstanding debt as well as the sale related costs and, if any surplus is left, will transfer this surplus to the borrower.

The sale of the property is a transaction that happens directly between the borrower and the new purchaser. The bank is not involved in this sale other than as having facilitated it. In the case at hand, the sale is not a supply falling in the scope of VAT as the seller (i.e., the borrower) is not a taxable person.

If the sale was done by the bank on behalf of a borrower taxable person, that sale would fall within the scope of VAT (e.g., a borrower taxable person who is forced by the bank to sell his offices).
In order to facilitate the sale of the property, the bank incurred a certain number of costs on behalf of the borrower (e.g., legal costs associated to the sale agreement, property diagnostic costs, etc.) that it will recover from the property sale proceeds.

For these costs, the bank is expected to recover from the borrower the amounts as invoiced by the various suppliers (i.e., no VAT must be charged by the bank on the recovery of these costs). If these costs have been charged with VAT by their respective suppliers, the bank cannot claim this VAT back in its tax return and must instead recover it from the borrower.

5.2.1.3. Syndicated loans

Overview of products / services

A syndicated loan is a loan offered by a group of lenders (the "syndicate") who provide funds to a single borrower.

In a syndicated loan, there is typically a lead bank, usually referred to as the arranger, the agent or the lead lender. This lead bank usually carries out administration and management of the loan on behalf of the syndicate members, such as arranging the financing as well as collecting the loan repayments and interest from the borrower and allocating the relevant share of these to the syndicate members. The lead bank may charge a fee to the syndicate members for the administration and management services it carries.

VAT treatment

When the loan contract has been entered into between the borrower and all the members of the syndicate, each member of the syndicate will be considered as providing a financing service to the borrower, for their respective portion of the loan.

Financing services

When the lead bank collects the total payment due by the borrower to the syndicate and allocates this payment between the syndicate members, it will be considered as a disclosed agent, acting in the name and on behalf of each syndicate member (please see Appendix C for further detail on disclosed agents). Under a disclosed agency arrangement:

- The lead bank will recognize a supply of financing services to the borrower solely for the portion of the interest to which it is entitled as lender (the repayment of the amount loaned will be disregarded for VAT purposes)
- Each syndicate member will recognize a supply of financing services to the borrower for the portion of the interest to which they are entitled as lenders (the repayment of the amount loaned will be disregarded for VAT purposes).

The fact that the syndicate members receive the payment from the lead bank, after the latter collected the total amount due from the borrower, is irrelevant and must be disregarded.

The VAT treatment of financing services provided under a syndicated loan is exactly the same as under a non-syndicated loan (see section 5.2.1.1 of this Guide).

For the sake of completeness, where the financing arrangement is entered into between the borrower and a single lender (who then sources other lenders without them having a direct relationship with the borrower), the lending service will be considered as provided by that lender to the borrower in its entirety. The sourced lenders will be considered as providing a lending service to that lender.

Syndicate administration services

Syndicate administration and management services conducted by the lead bank will generally be supplied to the syndicate members for the portion of fee they are respectively charged by the lead bank.

In principle, these services follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable on the administration and management services, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Such services would generally be regarded as continuous supplies of services for the purposes of the tax due date rules.

When, in practice, the fee is netted against the payment to be made by the lead bank to each syndicate member (i.e., the lead bank directly withholds its fee from the interest income amount to be paid to each syndicate member), such netting must be disregarded for VAT purposes so that the service fee is identified and the correct VAT treatment is applied to it.

When the lead bank is the person liable to charge VAT on the services, it is required to issue separate tax invoices to each syndicate member for their respective portion of the service fee.

Example

A business, taxable person resident in Bahrain, needs significant financing for a new infrastructure development project. The financing is granted by a syndicate of 3 Bahraini banks, contributing respectively 40% (Bank A), 30% (Bank B) and 30% (Bank C) of the financed amount. The borrower enters into the syndicated lending agreement with the 3 lenders.

Bank A has been appointed "lead bank" and is in charge of collecting the payments due by the borrower to the syndicate (i.e., principal amount and interest).

It has also been agreed between the 3 banks that Bank A will be entitled to charge an administration fee to Bank B and Bank C in consideration for its administration services (administration of the syndicate and collection of repayments from the borrower).

Every quarter Bank A collects the total amount due by the borrower to the syndicate and proceeds with the following:

- *Bank A keeps 40% of it for its portion of the financing services:*
- *Bank A will disregard the portion of the payment which corresponds to the re-paid principal amount (outside the scope of VAT) and will treat the interest income as VAT exempt.*
- *Bank A allocates 30% of the payment collected from the borrower to Bank B and deducts from this amount the fee earned for its administration services:*
  - *Bank A is required to charge VAT at the standard rate of 5% on the fee it has deducted from the allocation made to Bank B. Bank A must issue a valid tax invoice to Bank B for this fee*
  - *Bank B recognizes a loan repayment amounting to 30% of the payment collected by Bank A from the borrower (i.e., amount to be paid by Bank A before netting against the administration fee). Bank B must disregard the portion of the repayment corresponding to the re-payment of principal amount and must treat the other portion (i.e., the interest income) as VAT exempt.*
- *Bank A allocates 30% of the payment collected from the borrower to Bank C and deducts from this amount the fee earned for its administration services. The same treatment as the one explained above for the allocation to Bank B will apply.*

5.2.2. Asset financing

Asset financing refers to the provision of a financing service or credit facility directly linked to the acquisition of a specific asset when a separate charge for this financing is made and disclosed to the acquirer.

Asset financing products may generally take the form of credit sales, conditional sales, hire-purchase arrangements and finance leases:

- Credit sales: the goods immediately become the property of the customer even if the price is payable in instalments.
- Conditional sales: the acquisition price of the goods is payable by instalments and the goods remain the property of the seller until the full price is paid and / or any other conditions are met by the customer.

- Hire-purchase and finance leases: the goods remain the property of the lessor and are hired for periodic payments with the lessee having the option to purchase them. The lessee bears all costs and risks associated with the use of the leased asset.

Operating leases are generally considered as a financing arrangement. However, they are treated differently for VAT purposes.

5.2.2.1. Asset finance arrangements

Overview of products / services

Financing contracts may be offered to the purchaser of the goods either by the dealer or by banks or finance companies interposed between the dealer and the purchaser.

Self-finance arrangement

Under the first scenario, where the dealer itself offers a financing arrangement to the purchaser of the goods (i.e., self-financed arrangement), the following supplies occur for VAT purposes:

a. A supply of goods (the asset), for the price of the asset stated in the agreement

b. A supply of financing / credit services, for the separate charge

Third party financed arrangement

Under the second scenario, when a bank or finance company is interposed between the dealer and the purchaser (i.e., third party financed arrangement), the bank or finance company will take title of the goods from the dealer while the purchaser will be allowed to use the goods. In this case, the following supplies occur for VAT purposes:

a. A supply of good (the asset) by the dealer to the bank or finance company for the price of the asset stated in the agreement

b. An onward supply of the asset by the bank or the finance company to the purchaser for the same price as the one charged by the dealer

c. A supply of financing / credit services by the bank to the purchaser for the separate charge made and disclosed to the purchaser.

VAT treatment

a) Supply of the asset

The supplies of the asset, by respectively the dealer and the bank or finance company, follow the place of supply rules applicable to supplies of goods (see Appendix A of this Guide).

When supplied in Bahrain, the goods are subject to VAT at the standard rate of 5%, unless they fall in the scope of one of the zero-rating or VAT exemption provisions applicable to goods.

The supply of the asset is considered as a one-off supply of goods and the fact that the goods will be paid by instalment does not make as the supply a continuous supply of goods:

- VAT becomes due on the supply of the goods by the dealer at the time the goods are put at the disposal of the purchaser (unless a tax invoice is issued or a (partial) payment is received prior to that date). The dealer is required to issue a tax invoice to either the purchaser or the bank or finance company (depending on whether a bank or finance company is involved).
- VAT becomes due on the supply of the goods by the bank or the finance company to the purchaser at the time the goods are put at the disposal of the purchaser (unless a tax invoice is issued or a (partial) payment is received prior to that date)[2]. The bank or finance company is required to issue a tax invoice to the purchaser.
- No VAT is chargeable on the instalments paid by the purchaser as this VAT has already been charged upfront.

VAT becomes due on the supply of the asset by the dealer / the bank to the purchaser no later than by the time the asset is put at the disposal of the purchaser. This is irrespective of the fact that the dealer / the bank will remain the legal owner of the asset during the financing period and that the legal title will only pass at the end.

For hire-purchase and finance lease arrangements, the option to acquire the asset and the fact that the lessee will use the asset and bear the costs and risks associated with it are considered critical features for a supply of this asset to be regarded as being supplied when the asset is placed at the disposal of the purchaser from a VAT perspective.

The value of the supply of the asset is the price of the goods as stated in the sale agreement.

When a bank or finance company is involved in an asset financing arrangement and is regarded from a VAT perspective as buying and selling the asset, the following will happen with regards its input tax recovery position:

- It will be able to recover in full the VAT charged by the dealer on his taxable supply of the asset (because the bank or finance company will use the asset for the purpose of making an onward taxable supply)
- The sale of the asset by the bank or finance company to the purchaser must not be taken into account for the purpose of computing the bank or finance company's input VAT recovery apportionment ratio under the standard method (see section 9.6.1 of this Guide). This sale must be excluded from the ratio computation as its inclusion may be distort the bank or finance company's recovery position. This is because the sale of a capital asset,

2 The dealer / bank may ask the purchaser of the asset to pay the VAT due on the value of the asset upfront or may agree to include this VAT amount in the amount to be financed (i.e., the purchaser will also pay on instalment an amount corresponding to the VAT due on the asset). This is a commercial agreement between the parties which does not impact the fact that the dealer / bank remains liable to report and pay to the NBR the full amount of VAT due on the supply of the asset upfront.

as well as any supply which is not part of the core activities of a business and may distort that business's recovery position, have to be excluded from the apportionment ratio.

b) Supply of the financing service

The supply of a financing service, provided it is remunerated by way of a separate interest or similar charge, is a financial service for VAT purposes.

These services follow the same VAT treatment as the financing and credit services analysed above under the loans, credit and overdrafts category at section 5.2.1

Example

Malek, taxable person resident in Bahrain, wants to acquire a new tractor and asks for financing from a specialized finance company which is a taxable person resident in Bahrain.

The finance company acquires the tractor from the dealer and immediately enters into a 48-month hire-purchase arrangement with Malek. At the end of the 48-month period, assuming Malek complies with all his payment obligations, the legal title of the tractor will be transferred from the finance company to Malek.

The selling price of the tractor is BHD 9,000 (VAT exclusive).

The finance company will apply a margin (interest) of 6.5% on each instalment paid by the farmer :

- *Monthly repayment for the tractor (BHD9,000 / 48 months) : BHD 187.500*
- *Margin (interest) applied (BHD188.500 * 6.50%): BHD 12.187*

The following happens in terms of VAT:

a. Supply of the tractor from the dealer to the finance company

The dealer is registered for VAT in Bahrain and charges 5% VAT on the selling price of the tractor (i.e., BHD 450; 5% of BHD 9,000).

The dealer will be required to charge VAT on the earliest of the payment received by the bank, the issue of his tax invoice or the tractor being put at the disposal of the farmer.

The dealer must issue a valid tax invoice to the finance company and the finance company will be able to claim this VAT back in its tax return.

b. Supply of the tractor from the finance company to Malek

The finance company charges 5% VAT on the selling price of the tractor (i.e., BHD 450; 5% of BHD 9,000).

The finance company will be required to charge VAT on the day the tractor is put at the disposal of Malek (unless a tax invoice or a payment is received beforehand).

The finance company must issue a valid tax invoice to Malek and Malek may be able to claim this VAT back in its tax return (subject to general input tax recovery rules).

Example (continued)

In the case at hand, Malek decides to pay the finance company upfront for the VAT due on the selling price of the tractor. This VAT is therefore not included in the amount financed.

c. Supply of financing services from the finance company to Malek

The finance company does not charge VAT on the margin realized on the monthly payment (i.e., BHD 12.187).

This is because this margin (interest) is VAT exempt: it is the consideration for a financing service remunerated by way of margin/interest.

The finance company is not required to issue tax invoices for the margin earned on a monthly basis. It will have to make sure that it is able to electronically extract and provide, upon request of the NBR, the details of this VAT exempt income.

The financing services should be considered as a continuous supply of services for the application of the tax due date rules.

d. Regarding the finance company's input tax recovery position

The finance company can recover in full the VAT incurred on the acquisition of the tractor from the dealer (provided it is in possession of a valid tax invoice issued by the dealer).

The value of its taxable sale of tractor to Malek must not be included for the computation of its input tax recovery apportionment ratio under the standard method.

The value of the margin / interest income must be included for the computation of its input tax recovery apportionment ratio under the standard method.

Other fees and charges related to asset financing

Some fees may be charged as part of the financing arrangement such as an application or a documentation fee.

These services follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable unless the conditions to apply the zero-rate of VAT (for export of services) are met.

When charged by the dealer to the bank or finance company, the VAT incurred on such fees should not be recovered by the bank or the finance company unless these are recharged by the bank or the finance company to the purchaser. In this case, the VAT charged by the dealer becomes fully recoverable for the bank or the finance company.

Intermediary / Agency fee

Banks or finance companies may also pay a fee or a commission to a dealer for the introduction of a new customer (agency fee or commission).

These are regarded as financial services (i.e., intermediation in supplies of financial services) and follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

The VAT charged by the dealer on such fees / commission should not be recovered by the bank or the finance company as they are used for the purpose of performing VAT exempt financing supplies.

Return or repossession of the assets

Sometimes finance agreements do not run their full course and the goods are returned or repossessed.

The VAT treatment of returned or repossessed assets will depend on the financing contract under which the asset acquisition is financed.

When goods are supplied under hire-purchase, finance lease or conditional sale agreements (i.e., when the title in the goods does not pass until all payments due under the agreement are received), the return or repossession of the goods due to an early termination of the contract will trigger an obligation for the lessor to adjust the amount of VAT accounted for at the beginning of the agreement. In this respect he will be required to issue a tax credit note to the purchaser (see section 8.10.2 of this Guide for further detail).

This is provided the lessee, upon return or repossession of the goods, is liable to pay nothing more or a lesser amount than the amount initially agreed in the contract.

In order to compute the VAT adjustment, the lessor will have to separate, within the reduction of price triggered by the contract termination, the portion of capital (corresponding to the value of the asset) from the portion of interest. The VAT adjustment should be made on the capital portion. Any reasonable and consistent method for apportioning the value of the reduction may be used.

Where goods are supplied under a credit sale agreement (i.e., where the title in the goods passes immediately to the purchaser), the return or repossession of the goods due to an early termination of the contract will be treated as a supply of this good from the purchaser to the dealer / bank. The value of the original sale by the dealer / bank is not affected by the return.

Where the goods are repossessed following default by the purchaser, and there is still an amount outstanding after repossession, the dealer / bank or finance company may be entitled to claim the output VAT back on this outstanding amount under the Bad debt relief provisions, provided all the relevant conditions for bad debt relief are met (see the “Bad debts relief” section in the VAT General Guide for further detail).

5.2.2.2. Operating leases

Overview of products / services

An operating lease is a contract that allows for the use of an asset but does not confer rights of ownership of the asset (neither automatically nor by option).

Operating leases are usually categorized as asset financing arrangements. However, from a VAT perspective, operating leases do not follow the same VAT treatment as the other financing arrangements analysed above. This is because they do not place the lessee in the position of becoming the owner of the goods and there is, in principle, no intention to do so.

The key distinction between an asset financing product and an operating lease is that an operating lease contract does not allow for the ownership of the underlying asset to pass to the recipient. It is intended that, at the end of the term, the lessee will return the goods to the lessor, and enter into a new leasing contract if required. An operating lease does not contain a financing element and these contracts are not treated as financial services for VAT purposes.

VAT treatment

From a VAT perspective, operating leases are supplies of services.

They follow the general place of supply rules applicable to services, unless they fall under one of the special rules (see Appendix A of this Guide for further detail).

When supplied in Bahrain, VAT at the standard rate of 5% is applicable unless the conditions to apply a zero-rate of VAT or a VAT exemption are met.

When applicable, VAT is charged on the rent received by the lessor and becomes due on the earliest of:

- The due dates of payment of the rents, as agreed in the contract; or
- The date where a payment is received

5.2.3. Servicing of loans

Overview of products / services

Loan servicing refers to the administrative aspects of a loan from making the principal amount available to the borrower until the loan is paid off. Loan servicing usually includes sending periodic payment statements, collecting the periodic payments, maintaining records of payments and balances, following up on delinquencies, etc.

Banks and financial institutions may either carry out the servicing internally or outsource (part of) it to third parties.

VAT treatment

When supplied for consideration (usually when outsourced), such services are not regarded as financial services, as they are merely administrative in nature, rather than being financial.

The above services follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Loan servicing will usually be a continuous supply of services for the purposes of tax due date rules.

In practice, the loan servicer may net his fee directly against the payment to be remitted to the lender (where the servicer is in charge of collecting the amounts due by the borrower, on behalf of the lender). Such netting must be disregarded from a VAT perspective and the correct VAT treatment should be applied on the servicing fee.

5.2.4. Services of intermediaries

Overview of products / services

There are businesses involved in credit and financing transactions without being direct parties to the actual financing arrangement. These businesses are usually referred to as “intermediaries” between the parties to a financing arrangement.

These are notably brokers, who assist customers in finding and negotiating a suitable financing arrangement, according to the specific requirements and features of the customers, or arrangers, who will act as intermediaries in negotiating and arranging the terms and conditions of complex financing contracts on behalf of one of the parties.

The remuneration of these intermediaries is generally in the form of commission (e.g., variable fixed commission based on the financed amount negotiated) or success fee (e.g., a fixed minimum fee with an additional variable amount to be paid in case of successful completion).

VAT treatment

These services would generally be regarded as financial services and follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Intermediary services for the purpose of a specific financing transaction will usually be a one-off supply of services for the purposes of tax due date rules. It is however recommended to confirm the position based on the exact terms and conditions of existing agreements, as there may be instances where such intermediaries may also carry out continuous supplies of services (e.g., in case of a retainer arrangement).

5.3. Debts and debts related services

This section focuses on transactions related to debts.

Please consult section 5.4 of this Guide for further detail on transactions related to debts securities, as these are not covered in this section.

5.3.1. Sale vs assignment of debts

From a VAT perspective, it is important to distinguish between the assignment of a debt and the sale of a debt as their respective VAT treatment is not the same:

- The sale of a debt falls within the scope of VAT and is considered as a VAT exempt supply of financial services (or zero-rated if it qualifies as an export of services)
- The assignment of a debt is outside the scope of VAT and is not considered as a supply for VAT purposes

Sale of a debt

A sale of a debt occurs when a purchaser acquires ownership of a debt from a creditor for consideration.

On the sale of a debt, all legal and beneficial interests in that debt pass to the buyer to whom full title and risk is transferred, and the purchaser assumes all the rights and obligations of the original creditor.

The purchaser of a debt has, in principle, no right of recourse to the seller for unrecovered debt. Unless there is a chargeback agreement for unpaid balances, the purchaser will write off any unrecovered debt and incur the loss.

The sale of a debt is a financial service which follows the general place of supply rules applicable to services.

When supplied in Bahrain, the sale of a debt is exempt from VAT, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

The sale of a debt is VAT exempt in Bahrain, regardless of the form of the consideration of this sale.

The sale of a debt is a one-off supply of services for the purposes of the tax due date rules.

Assignment of a debt

An assignment of a debt involves the equitable (i.e., beneficial) title only in the debt being passed to the assignee. The assignor retains the legal title in the debt and any liability to any obligations arising from the original contract. Often it is not possible for the assignee to sell the debt it has been assigned.

5.3.2. Factoring (with recourse)

Overview of products / services

Factoring with recourse is when the owner of a debt assigns the debt to a third party (the factor) for collection and receives, from that third party, a pre-payment of a portion of this debt (i.e., earlier than the payment due date).

“With recourse” means that, if the factor cannot recover the money from the debtor, it will reassign the debt back to the client (i.e., the factor does not bear the risk of non-payment of the debt).

In factoring with recourse, the client is first required to assign his debt to the factor. This assignment of beneficial ownership is required to enable the factor to fulfil his services. This assignment is not a supply for VAT purposes and does not trigger any event for VAT purposes.

Once the debt has been assigned, the following tends to occur:

- The factor opens a client account to which he credits the face value of the debts he has been assigned
- The factor will debit from the client account his charges, usually referred to as the “discount”, for the factoring services supplied (e.g., full sales ledger management service, credit advice, debt collection service, provision of management information)
- The balance is available for the client to draw upon
- It may be that the factor also debits a further interest charge, in addition to the discount, for the provision of the line of credit (i.e., interest separately identified and charged to the customer)

The fact that the factoring arrangement can be disclosed or undisclosed does not impact the VAT treatment detailed above.

VAT treatment

Discount for factoring services

Factoring services are merely administrative and are not financial services.

The factoring services follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Factoring services are generally regarded as a continuous supply of services for the purposes of the tax due date rules.

When the service charge is directly discounted from the face value of the debt assigned (i.e., the customer receives a net amount equal to the face value of the debt minus the factor’s

discount), the factor must clearly identify the discount and apply the correct VAT treatment on its value.

Separate interest charge (if applicable)

Interest charged by the factor for the provision of the line of credit will be the provision of financial services (i.e., availability of a line of credit). This is if the interest is identified and charged separately from the discount.

In principle, such services follow the general place of supply rules applicable to services.

When supplied in Bahrain, they are VAT exempt, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

For the purposes of the tax due date rules, the provision of a line of credit would generally be regarded as a continuous supply of services.

Please see section 5.2.1 of this Guide for further detail on the VAT treatment of financing services.

5.3.3. Factoring (without recourse) and forfaiting

Overview of products / service

Factoring without recourse is when the owner of a debt sells his debt to a third party (the factor) and receives in consideration, from that third party, a cash payment equal to the amount of the debt less a discount.

“Without recourse” means that if the factor cannot recover the money from the debtor, it cannot reassign the debt back to the client and therefore bears the risk of non-payment of the debt.

Forfaiting involves the sale of a debt whereby the forfaiter (usually a bank) purchases, on a “without recourse” basis and at discounted cash payment, an unconditional debt which has arisen from a supply of goods or services by a business (usually an exporter).

VAT treatment

The sale of the debt from the owner / business to the factor / forfaiter is a VAT exempt supply of financial services (or zero-rated if it qualifies as an exported service).

In these two arrangements are on a “without recourse” basis, the discount is not the remuneration for a supply of services from the factor / forfaiter to the owner / business. The discounted cash payment is the price at which the parties agree to respectively sell and acquire the debt in consideration for a payment made in cash and any possible risks associated with the debt.

For the purposes of the tax due date rules, factoring without recourse and forfaiting would generally be regarded as one-off supplies of services.

When the factor / forfaiter collects the payment of the debt from the debtor, this payment is not consideration for any supply made by the factor / forfaiter and is therefore outside the scope of VAT.

Input tax recovery

The VAT exempt sale of the debt by the owner / business to the factor / forfaiter should not be taken into account in computing the owner / business' input tax recovery apportionment ratio (see section 9.6 of this Guide for further detail).

If the owner has incurred taxable expenses that are directly and exclusively related to the sale of the debt, the VAT on these expenses cannot be recovered as these expenses have been used to make a VAT exempt supply (unless the sale of the debt qualifies as export of services subject to VAT at the zero-rate).

5.3.4. Securitization

Overview of products / services

Securitization involves the transfer of debts by the owner (the "originator"), on a "without recourse" basis, to a third party (usually a Special Purpose Vehicle ("SPV")).

The main differences between securitization and factoring ("without recourse") are:

1. The type of debts transferred – for securitization, these will usually be longer term debts which are less liquid than trade receivables; and

2. The type of transferees – for securitization, the transferee will usually be an SPV which raises capital from investors with a view to acquiring the debts.

VAT treatment

Securitization of debts

The sale of debt for cash consideration will generally be done at a lower price than the face value of that debt. The discount is not the remuneration for a supply of services from the SPV to the originator. The discounted cash payment is the price at which the parties agree to respectively sale and acquire the debt, subject notably to a payment made in cash and the risks associated with the debt (e.g., if the debt is a non-performing loan).

The sale of the debt from the originator to the SPV (or any third party) is a VAT exempt supply of financial services (or zero-rated if it qualifies as an export of services).

If the debts acquired are interest bearing (e.g., the debts are loans or mortgages), the receipt of interest by the SPV (or any third party) is remuneration for a supply of financing services by that SPV to the debtors. This is because the SPV stepped into the shoes of the initial creditor when it acquired the debts and is now considered as providing the financing services itself.

The repayment of the debts (principal amounts) by the debtor to the SPV is not consideration for a supply by the SPV and is outside the scope of VAT.

The VAT exempt sale of the debt by the originator to the SPV is not to be taken into account in the computation of the originator's input VAT recovery apportionment ratio (see section 9.6 of this Guide).

If the originator has incurred taxable expenses that are directly and exclusively related to the sale of the debt, the VAT on these expenses cannot be recovered, as these expenses have been used in making a VAT exempt supply (unless the sale of the debt is an export of services subject to VAT at the zero-rate).

Servicing of the debts

Once the debts have been transferred to the SPV, this SPV will generally appoint a "servicer" who will be responsible for the administration of the debts (e.g., day-to-day administration, collection and transfer of the funds from the debtors to the SPV).

The servicer (typically the originator) will receive a fee from the SPV for this service. This fee is generally set at a percentage of the aggregate balance of the debts or the funds collected.

The fee charged by the servicer for the provision of its services is of a mere administrative nature and is not a financial service.

Servicing of debts follows the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Servicing debt would generally be regarded as a continuous supply of services for the purposes of the tax due date rules.

5.3.5. Debt collection

Overview of products / services

Debt collection services consist of attempting to collect payments from a debtor on behalf of a creditor; i.e., to ensure that the debtor either pays the outstanding balance immediately or begins / continues repayments of the outstanding balance in staged payments. The provision of debt collection services does not involve the service provider taking an assignment of the debt.

Debt collection services are usually provided by debt collection agencies, which typically charge a fee or commission based on amounts recovered.

Debt collection agencies may also offer additional services to the creditor, such as status enquires and company searches, repossession and card recovery, call centre support, etc.

VAT treatment

Fees or commissions charged by the debt collection agency for the provision of its services are of an administrative nature and not financial services.

Debt collection services follow the general place of supply rules applicable to services.

When supplied in Bahrain, VAT at the standard rate of 5% is applicable, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Debt collection services would generally be regarded as a continuous supply of services for the purposes of the tax due date rules.

5.4. Capital and money markets

This section focuses on the products and services associated with capital and money markets, specifically on transactions related to equity and debt securities.

5.4.1. Introduction to equity and debt securities

Equity security

An equity security, for VAT purposes is a tradable (not necessarily on a stock exchange) financial instrument representing an ownership interest held in an entity. Equity securities include shares of capital stock.

Shares in companies are the most basic form of equity security and will usually, but not always, have some or all of the following features:

- Voting privileges
- A share in the profits payable by way of a distribution, i.e., dividends
- A proportionate share of the assets of the business in the event of a winding up (after payment of creditors)
- Subscription privileges in the event of a new issue of shares (pre-emptive rights)

Debt security

A debt security, for VAT purposes, is a loan, a debt and any tradable instrument which is issued to evidence a contractual obligation to make payment(s) of interest and / or to repay the stated principal amount on a stated future date or dates.

A debt security generally entitles its holders to receive a payment(s) of interest and repayment of principal (regardless of the issuer's performance). Debt securities are issued for a fixed term, at the end of which they can be redeemed by the issuer. Government and corporate bonds, certificates of deposit (CDs), fixed rate bonds and zero-coupon bonds are, for instance, debt securities.

5.4.2. Issue of equity and debt securities

Overview of products / services

Issuing equity and debt securities is where the issuer raises capital from investors by way of either equity or debt. Equity and debt securities are issued on the primary market either publicly (Initial Public Offering - IPO) or through private placement.

VAT treatment

The issue of equity and debt securities is outside the scope of VAT. This is because the issuer of the securities does not provide any supply of goods or services to the holders of the securities in exchange for their capital contribution.

The costs incurred by the issuer in relation to the issue of the securities (e.g., underwriting costs, professional costs, etc.) should be treated as business overhead costs for the VAT purposes when they are incurred to fund the issuer's overall business activities. Therefore, the issuer, if he is a taxable person, may be able to (partially) recover the VAT incurred on these costs, in accordance with the general principles for input tax recovery (see section 9 of this Guide for further detail on input tax recovery). This position applies to equity and debt securities issued on a primary market either publicly (Initial Public Offering - IPO) or through private placement.

The holders of the securities may receive payments that arise due to their holding:

Table 6: Treatment of securities-related payments

Payment	Description	Treatment
Dividends	Receipt of dividends by the holder of equity securities	Outside the scope of VAT
Interest / coupon	Receipt of interest / coupon by the holder of a debt security	Exempt from VAT or outside the scope of VAT – depending on the VAT status of the securities holder (i.e., taxable person or not)
Repayment of principal	Repayment of principal by the security issuer to the security holder	Outside the scope of VAT

5.4.3. Underwriting services

Overview of products / services

In order to issue equity or debt securities to the public (IPO), an issuer will usually request the assistance of an underwriter.

Underwriting is a service whereby the underwriter guarantees to the issuer of equity or debt securities that the IPO will raise the amount of capital needed. In order to make good on the guarantee, the underwriter may apply for, or will find other applicants for, all or part of an issue of equity or debt securities which is not otherwise taken up.

For his services the underwriter will usually receive a commission from the issuer, as well as an option, to acquire the unsubscribed securities at a special price (lower than the issue price).

VAT treatment

Both the commission and the option are the consideration for the supply of a financial service (i.e., a securities underwriting service).

Securities underwriting services follow the general place of supply rules applicable to services.

When supplied in Bahrain, the commission paid by the issuer is subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

When supplied in Bahrain, the option granted by the issuer to acquire the securities is exempt from VAT, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Underwriting services would generally be regarded as a one-off supply of services for the purposes of the tax due date rules.

5.4.4. Sale of equity and debt securities

Overview of products / services

Holders of equity or debt securities may dispose of their securities by selling them on the secondary market.

VAT treatment

The sale of equity or debt securities is a supply of financial services which follows the general place of supply rules applicable to services.

When supplied in Bahrain, the sale of equity or debt securities is exempt from VAT, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

The sale of equity or debt securities is a one-off supply of services for the purposes of the tax due date rules.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide for further details).

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices, provided they are able, upon request of the NBR, to electronically extract and provide details of their VAT exempt financial services income. The NBR auditors may still audit records through any other means.

Input tax recovery

When computing the seller's input tax recovery apportionment ratio under the standard method, the margin realized on the sale of the securities should be taken into account (see section 9.6 of this Guide for further detail).

5.4.5. Securities lending

Overview of products / services

Lending of equity securities is when a person borrows securities from another person to fulfil an equity securities transaction to which he is committed. The borrower agrees to return an equivalent number of the same securities at a later date.

The lender of the securities will usually charge a fee to the borrower and may also realize a margin as a result of the lending.

VAT treatment

Securities lending services follow the general place of supply rules applicable to services.

When supplied in Bahrain, the lending of equity securities is exempt from VAT, unless the conditions to apply the zero-rate of VAT (for export of services) are met. This is irrespective of whether the remuneration is by way of fee or implicit margin.

The lending of equity securities is a continuous supply of services for the purposes of the tax due date rules.

When the borrower repays the lender (in an equivalent number of the same securities) there is no supply for VAT purposes.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide for further details).

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices provided they are able, upon request of the NBR, to electronically extract and provide the details of their VAT exempt financial services income. The NBR auditors may still audit records through any other means.

Input tax recovery

When computing the lender's input tax recovery apportionment ratio under the standard method, the fee, as well as the margin realized on the lending (if any), must be taken into account (see section 9.6 of this Guide for further detail).

5.4.6. Other services associated with equity and debt securities

Overview of products / services

A variety of services are supplied in connection with equity and debt securities, such as (non-exhaustive list):

- Exchange listing services
- Clearing and settlement services
- Electronic messaging services (SWIFT)
- Nominee services
- Registrar services
- Global custody services
- Brokerage services
- Negotiation services
- Data, research, advisory, valuation and other professional services

Such services are generally supplied in consideration for a fee or a commission.

VAT treatment

These services generally follow the general place of supply rules applicable to services.

When supplied in Bahrain, the fees and commissions paid for these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Table 8: Treatment of securities-related services

Services	VAT treatment in Bahrain	Comments
Issue of equity and debt securities	Outside the scope of VAT	The issue of equity or debt securities with the intention to raise capital is not a supply
Sale of equity and debt securities	VAT exempt Zero-rated (if export of services)	The sale of equity and debt securities is an exempt supply by nature

Services	VAT treatment in Bahrain	Comments
Securities lending	VAT exempt Zero-rated (if export of services)	The lending of securities is an exempt supply by nature
Underwriting	Taxable VAT exempt (or zero-rated)	Underwriting fees and commission are taxable Margin realized by underwriter (if any) is VAT exempt
Exchange listing services	Taxable	Services remunerated by a fee
Brokerage services	Taxable VAT exempt (or zero-rated)	Brokerage fee or commission is taxable Margin realized (when broker acts as principal / counterpart) is VAT exempt
Other services (registrar, SWIFT, clearing and settlement, date and research, professional services, etc.)	Taxable	These services are generally remunerated by way of fee or commission

5.5. Financial derivatives

5.5.1. Supply of financial derivative contracts

Overview of products / services

Derivatives are tradable financial instruments, the price of which is directly dependent upon the value of an underlying commodity, financial instrument or currency.

Only the supply of financial derivatives contracts is treated as financial services for VAT purposes. Non-financial derivative contracts are treated differently for VAT purposes and this is not covered in this Guide.

Financial derivatives contracts are instruments traded based on the value of financial underlying such as currencies, interest rates, securities and other cash-settled contracts.

Cash-settled contracts are contracts where settlement is not made through the actual delivery of the underlying asset, but by way of transfer of the net cash position from the buyer of the contract to the seller of the contract (the net cash position triggering either a loss or a profit for the seller of the contract).

Financial derivatives contracts include forwards, futures, swaps and options.

- A forward contract is an "over the counter" ("OTC", i.e., not traded on an established exchange) contract to respectively buy and sell an underlying asset at a future date at a fixed price agreed at the time of the contract initiation. Forward contracts are direct agreements between the parties to the contract.
- A futures contract is similar to a forward contract except that it is a standardized contract traded on an established exchange. The buyer in a futures contract is usually referred to as the "long position holder" and the seller as the "short position holder".
- A swap contract is an OTC contract between two parties who exchange, for a predetermined time, their cash flows or liabilities from two different financial instruments.
- An option contract is a contract allowing one of the parties the right to buy or sell a financial instrument at a pre-decided price. It is to be executed on or before the date of expiry of the contract.

The supply of a financial derivatives contract is recognized at the time the contract is settled (i.e., pre-decided date agreed in the contract for forwards and futures) or when the contract is exercised or expired (for options) or when the contract terminates (for swaps).

VAT treatment

The remuneration for the supply of a financial derivatives contract is the profit margin realized by the seller of the contract at the time of settlement, exercise, expiry or termination of the contract.

The sale of a financial derivatives contract follows the general place of supply rules applicable to services.

When supplied in Bahrain, the sale is exempt from VAT, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

The sale of a financial derivatives contract is a one-off supply of services for the purposes of the tax due date rules.

Margin payments (whether initial or variation) made by the parties to a futures contract fall outside the scope of VAT.

Tax invoice requirement

The issue of a tax invoice is mandatory for supplies of services performed in Bahrain (see section 8 of this Guide for further detail).

For VAT exempt financial services remunerated by way of interest or a margin, taxable persons may choose not to issue tax invoices provided they are able, upon request of the NBR, to electronically extract and provide the details of their VAT exempt financial services income. The NBR auditors may still audit records through any other means.

Input tax recovery

When computing the seller's input recovery apportionment ratio, the margin realized on the sale of the financial derivatives contract (as opposed to the sale price) should be taken into account (see section 9.6 of this Guide for further detail).

5.5.2. Other services associated with the supply of financial derivative contracts

Overview of products / services

A variety of services are supplied in connection with the supply of financial derivatives contracts. These services are generally supplied in consideration for a fee or commission.

VAT treatment

These services generally follow the general place of supply rules applicable to services.

When supplied in Bahrain, the fees and commissions paid for these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Table 7: Derivatives-related services

Services	VAT Treatment in Bahrain	Comments
Brokerage services	Taxable VAT exempt (or zero-rated)	Brokerage fee or commission is taxable Margin realized (when broker acts as principal / counterpart) is VAT exempt
Clearing services	Taxable	These services are generally remunerated by way of a fee or commission

Services	VAT Treatment in Bahrain	Comments
Settlement services	Taxable	These services are generally remunerated by way of a fee or commission

5.6. Asset management

This section focuses on activities undertaken by banks and other financial institutions in relation to asset management, whether on a segregated basis (i.e., segregate investment management mandate) or on a pooled basis (i.e., management of collective investment schemes).

5.6.1. Discretionary asset management (segregated and pooled)

Overview of products / services

Discretionary management services consist of managing, in the name and on behalf of a customer, funds belonging to that customer. The management is done by the manager (generally a bank or another financial institution) on a discretionary basis (i.e., the manager makes investment decisions based on an investment mandate without requiring the customer's authorization).

When the manager invests his customer's funds, he does so as a disclosed agent of the customer and not as a principal (see Appendix C of this Guide for further detail on disclosed agents). As a result, the manager is not a party to the financial transactions that are entered into by his customer.

Discretionary asset management services can be supplied to a specific customer under a segregate mandate (e.g., a high net worth individual, an institutional investor) or to a pool of investors through a collective investment scheme (CIS). In the latter case, the services will usually be considered as supplied to the CIS as opposed to each investor separately.

In exchange for his asset management services the manager is entitled to receive a fee usually referred to as "investment / asset management fee". This fee may be structured in various ways with, for instance, a variable fee based on the value of the assets under management and an additional performance fee where certain targets are met.

VAT treatment

Discretionary asset management services are treated as financial services and follow the general place of supply rules applicable to services.

When supplied in Bahrain, the fees and commissions paid for these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Discretionary asset management services are generally regarded as a continuous supply of services for the purposes of the tax due date rules.

A discretionary asset manager may also charge a withdrawal fee to a customer who withdraws funds earlier than at the end of the initially agreed commitment period. Whether this charge falls within the scope of VAT (i.e., it is the remuneration for a supply of services by the asset manager to the customer) or as being outside the scope of VAT (i.e., it is a penalty or indemnity to which the asset manager is entitled as a result of the customer breaching his contractual obligations) requires a case-by-case analysis of the contractual terms agreed between the asset manager and his customer. We refer you to Appendix F of this Guide for further detail.

5.6.2. Investment advisory services

Overview of products / services

Investment advisory services consist of providing advice to customers with regards to their financial position and how they may wish to invest their funds.

Contrary to discretionary asset management services, the investment advisor is not given a mandate to make investment decisions in the name and on behalf of his customer.

Any transaction to be made with regards the customer's funds has to be specifically agreed to by the customer for the advisor to execute it (either directly or through the services of a broker).

Investment advisory services are usually remunerated by way of a fee or commission.

VAT treatment

Investment advisory services are regarded as financial services and follow the general place of supply rules applicable to services.

When supplied in Bahrain, the fees and commissions paid for these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Investment advisory services may be a one-off supply of services or a continuous supply of services for the purposes of the tax due date rules. This will depend on the terms and conditions of the advisory contract (e.g., whether the advisor is engaged for a one-off specific piece of advice or whether there is a retainer fee in place).

5.6.3. Execution services

Overview of products / services

Execution services generally comprise executing a specific financial transaction in the name and on behalf of a customer. The person executing the transaction acts as a disclosed agent (as opposed to being a principal) and is not a party to the transaction he is in charge of executing (see Appendix C of this Guide for further details on disclosed agents).

Brokerage services e.g., when buying or selling stocks on behalf of another person, are typical execution services.

Execution services are usually remunerated by way of a transaction fee or commission.

VAT treatment

Execution services in relation to a financial transaction are regarded as financial services and follow the general place of supply rules applicable to services.

When supplied in Bahrain, the fees and commissions paid for these services are subject to VAT at the standard rate of 5%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Execution services are generally one-off supplies of services for the purposes of the tax due date rules.

5.6.4. Collective Investment Schemes

Overview of products / services

Collective Investment Schemes (often referred to as “investment funds”) carry out an investment activity, on a pooled basis, for the account of their unit holders and within the limits of the set investment policy and any applicable regulations.

From a VAT perspective, an investment fund is considered as a separate person from its unit holders, even if this fund does not have a legal personality.

An investment fund is considered as capable of making and receiving supplies from a VAT perspective:

- The investment fund is considered as making supplies of financial services when selling the pooled assets (e.g., selling stocks) and when receiving VAT in-scope income from the assets (e.g., interest income from debt securities)
- The investment fund is considered as receiving supplies of services with regards the expenses incurred for the pooled assets (e.g., investment management services related to the pooled assets are considered received by the investment fund).

VAT treatment

Given the type of financial activities investment funds are engaged in, it is expected that they mainly perform VAT exempt, or partially zero-rated (when trading outside the Implementing States) activities. They are therefore expected not to be entitled to recover input tax incurred on their expenses, or only in a limited way. As a result, an investment fund may be required or eligible to register for VAT in Bahrain.

- Where the investment fund has its own legal personality (i.e., established as a corporate entity under the Bahrain Commercial Companies Law), it is able to apply and register for VAT directly.

- Where the investment fund has no legal personality (i.e., established either as Common, under the laws of contract or as Trust under the Financial Trust Law), it will be able to register for VAT through the person who has been appointed to represent it; i.e., its trustee.

When an investment fund without legal personality is registered for VAT through another person, which is itself registered for VAT because of its own activities, it is critical that this person makes a clear distinction between:

a) the fund's operations and related VAT, that have to be reported in the fund's tax return, and

b) his own operations and related VAT, that have to be reported in its own tax return.

The investors' investment in the fund (i.e., their cash contribution to the investment fund) and the redemption of units held by the investor (i.e., when a unit holder exits the fund) are outside the scope of VAT.

The return earned by the unit holders is usually also outside the scope of VAT.

5.7. Islamic Finance products

The VAT Law and its Executive Regulations provide parity in the VAT treatment of conventional finance products and Islamic Finance products, which are similar in terms of intended objective and which materially achieve the same results.

For their financing activities, Islamic Finance providers will usually earn a profit margin, realized on the purchase and sale of an underlying good. With parity of treatment in mind, this profit margin will therefore be treated the same way as interest received under an equivalent conventional finance contract.

Fees charged by Islamic Finance providers follow the same VAT treatment as equivalent fees charged by conventional finance providers (e.g., arrangement fee, administration fee, agency fee, etc.).

In determining the correct VAT treatment for Islamic Finance products, it is therefore critical to identify and assess the purpose, structure and pricing of each Islamic Finance product.

The below sections describe the main Islamic Finance products and the VAT principles applicable to them. These are general principles based on standard contracts.

It is nonetheless strongly recommended, when determining the appropriate VAT treatment of an appropriate Islamic Finance product, to always take into account the underlying purpose, features and circumstances of the product.

Any significant difference in the overall VAT liability between an Islamic Finance product and its non-Islamic counterpart would need to be addressed on a product by product basis.

5.7.1. Murabaha

Overview of products / services

A Murabaha contract in Islamic Finance is akin to a conditional sale financing arrangement in conventional finance.

VAT treatment

The remuneration for the financing services is the profit margin earned on the difference between the acquisition price of the good from the dealer and the total payment received from the purchaser.

The VAT treatment of a Murabaha contract and of the fees and commissions attached to it is the same as the VAT treatment applicable to a conditional sale contract. Please see section 5.2.2.1 of this Guide for further details.

5.7.2. Ijara (followed by sale)

Overview of products / services

An Ijara contract, when followed by a sale contract, is usually akin to a hire-purchase or finance lease arrangement in conventional finance.

There is, however, a distinction to be made depending on whether the Islamic Finance institution acts in its own name or in the name of its customer when acquiring the asset from the dealer. The exact terms and conditions of the Ijara contract will help in identifying the exact role of the Islamic Finance Institution.

VAT treatment

The Islamic Finance institution acquires the asset in its own name

The remuneration for the financing services is the profit margin earned on the difference between the acquisition price of the good from the dealer and the total payment received from the purchaser under the Ijara (and sale) contract.

In this scenario, the VAT treatment of the Ijara contract (followed by a sale) and of the fees and commission attached to it is the same as the VAT treatment applicable to a hire purchase or finance lease contract. This is further detailed in “Asset financing” under section 5.2.2.1 of this Guide.

The Islamic Finance institution acquires the asset in the name and on behalf of the customer

In this scenario, legal title directly passes from the dealer to the purchaser and the Islamic Finance institution only takes title by way of a security; i.e., the purchaser assigns the title to the Islamic Finance institution as a collateral (please see section 5.2.2.1 of this Guide for more information on the treatment of assets given as collateral as part of a finance agreement).

In this case, the supply of the asset happens directly between the dealer and the purchaser from a VAT perspective.

The Islamic Finance institution does not purchase or sell the asset and will only recognize a supply of financing services remunerated by way of a profit margin.

The Islamic Finance institution may also charge fees for its agency services or administration services in relation to the acquisition of the asset (e.g., Wakala fee, administration fee). When supplied in Bahrain, such services are subject to VAT at the standard rate of 5% or at the zero-rate (export of services).

Example

Rania, a private individual resident in Bahrain, wants to acquire a new car and asks for financing from her bank, which accepts under an Ijara (followed by sale) contract.

Under this agreement, the bank acquires the car from the dealer (i.e., Rania has no contractual relationship with the dealer) and immediately enters into a 60-month Ijara arrangement with Rania. At the end of the 60-month period, assuming she complies with her payment obligation, Rania will acquire the legal title of the car.

The selling price of the car is BHD 10,500 (VAT included).
The monthly installment to be paid by Rania is broken down as follows:

- *Car value (BHD10,500 / 60 months) : BHD 175*
- *Margin : BHD 7.875*

The following happens in terms of VAT:

a. Supply of the car from the dealer to the bank

The dealer is registered for VAT in Bahrain and charges 5% VAT on the selling price of the car (i.e., BHD 500; 5% of BHD 10,000).

The dealer will be required to charge VAT on the earliest of the payment received by the bank, the issue of his tax invoice or the car being put at the disposal of Rania.

The dealer must issue a valid tax invoice to the bank and the bank will be able the claim this VAT back in its tax return.

b. Supply of the car from the bank to Rania

The bank charges 5% VAT on the selling price of the car (i.e., BHD 500; 5% of BHD 10,000).

The bank will be required to charge VAT on the day the car is put at the disposal of Rania (unless a tax invoice or payment is received beforehand).

The bank must issue a valid tax invoice to Rania. However, Rania will not be able to claim this VAT, as she is not a taxable person.

In the case at hand, Rania decides to not pay the bank upfront for the VAT due on the selling price of the car. This VAT is therefore added in the amount to be paid to the bank by installment.

Example (continued)

c. Supply of financing services from the bank to Rania

The bank does not charge VAT on the margin applied on the monthly installment (i.e., BHD7.875).

This is because this margin is VAT exempt, i.e., it is the consideration for a financing service remunerated by way of margin.

The bank is not required to issue tax invoices for the margin earned on a monthly basis. It will have to make sure that it is able to electronically extract and provide, upon request of the NBR, the details of this VAT exempt income.

The financing services should be considered as a continuous supply of services for the application of the tax due date rules.

d. Regarding the bank's input tax recovery position

The bank can recover in full the VAT incurred on the acquisition of the car from the dealer (provided it is in possession of a valid tax invoice issued by the dealer).

The value of its taxable sale of car to Rania must not be included for the computation of its input tax recovery apportionment ratio under the standard method.

The value of the margin income must be included for the computation of its input tax recovery apportionment ratio under the standard method.

5.7.3. Ijara (lease only)

An Ijara contract in Islamic Finance is akin to an operating lease in conventional finance.

The remuneration for the rental services under an Ijara is the rent received from the lessee.

The VAT treatment of an Ijara contract is the same as the VAT treatment applicable to a conventional operating lease, which is described in section 5.2.2.2 of this Guide.

5.7.4. Commodity Murabaha / Tawarruq

Overview of products / services

Under this contract, an Islamic Finance institution uses commodities to support its financing activity:

- It purchases commodities (through a broker) and sells them at a higher price to the customer, on a deferred payment basis
- Upon acquisition, the customer will immediately resell the commodities at a price equal to the acquisition price initially paid by the Islamic Finance institution. The customer usually

sells the commodities with the help of the Islamic Finance institution which acts as his disclosed agent (see Appendix C of this Guide for further details on disclosed agent).

The difference between the purchase price paid by the Islamic Finance institution and the price at which it sells the commodities to the customer is the profit earned by the bank for its financing service.

VAT treatment

The profit is subject to the same VAT treatment as interest earned under a conventional loan or credit contract, i.e., it is VAT exempt in Bahrain (unless it comprises as an export of services subject to VAT at the zero-rate).

The sale of the commodities by the Islamic Finance institution to the customer is not recognized for VAT purposes and does not trigger any VAT event (i.e., the Islamic Finance institution is not considered as supplying the commodities to the customer) as long as there is no physical delivery of the commodities to the customer. This is because the title in the commodities, which is passed by the Islamic Finance institution to the customer, is not intended to remain permanently with the customer.

Under this contract, the only income recognized by the Islamic Finance institution for VAT purposes is the profit margin.

The brokerage fees charged for the purchase and sale of the commodities are taxable supplies of services when supplied in Bahrain. They are therefore subject to VAT at the standard rate of 5% or at the zero-rate (export of services), whichever is applicable.

VAT incurred by the Islamic Finance institution on brokerage fees paid to acquire the commodities is not recoverable, as it is used for the purposes of making a VAT exempt supply of financing services (unless the supply of financing services meets the conditions to be an export of services and is subject to VAT at the zero-rate).

Example

Ali, a private individual resident in Bahrain, needs a certain amount of money at short notice. He enters into a commodity Murabaha / Tawarruq agreement with his bank. Under this agreement:

a. *The bank purchases an amount of metals for BHD 2,500 and on-sells it to Ali for a marked-up amount of BHD 2,700, with deferred payment over twelve months (no physical delivery of the metals)*
b. *The bank arranges for Ali to on-sell the metals to a third party for an amount of BHD 2,500, payable to Ali immediately*

The transfer of title to the metals being not intended to stay permanently with, respectively, the bank and Ali, the sole income the bank will recognize for VAT purposes is the margin of BHD 200 which is exempt from VAT.

5.7.5. Musharaka

Overview of products / services

Musharaka is a partnership whereby each party contributes to the capital of the partnership in equal or varying degrees either to establish a new project or to share in an existing project. The profit is divided between the partners based on a pre-agreed ratio, while the losses are shared in proportion to capital contributed.

Musharaka contracts are used by Islamic Finance institutions and financial institutions to offer financing services. Constant or consecutive Musharaka contracts are usually used for long term financing / financing of a project or business while diminishing Musharaka contracts are usually used for the financing of a specific asset (e.g., a real estate).

VAT treatment

From a VAT perspective, the share of profit received by the Islamic Finance institution under a Musharaka agreement (i.e., over and above the capital contributed) is considered as profit margin and treated in a similar way as interest in a conventional financing agreement (see section 5.2 of this Guide for further details).

There is therefore no VAT applicable on the profit margin received by the Islamic Finance institution as the profit margin is consideration for a VAT exempt financial service (unless it meets the criteria to be an export of services and is subject to VAT at the zero-rate).

In case of diminishing Musharaka used for the joint acquisition of a specific asset (i.e., where the share of the Islamic Finance institution in the asset is gradually transferred to the “other party”), the Musharaka agreement is usually combined with an Ijara (followed by a sale) agreement whereby the “other party” pays the Islamic Financial institution instalment comprising both the right to use the specific asset and the purchase of the Islamic Finance institution’s share in that given asset. We refer you to the section 5.7.2 for further details on the VAT treatment applicable to Ijara contracts. The transfer of the Islamic Finance institution’s share in the given asset will follow the VAT liability of the asset transferred, while the profit earned by the Islamic Finance institution is consideration for a VAT exempt financial service (unless it meets the criteria to be an export of services and is subject to VAT at the zero-rate).

5.7.6. Mudaraba

Mudaraba is a partnership where capital is provided in cash by one party (the fund provider or rab al mal) and labour is provided by the other party (the fund manager or mudarib).

The contract should indicate the distribution ratio of profit between both parties and specify whether the Mudaraba is restricted or unrestricted. In addition to its share of the profit, the fund manager may also receive a fixed fee for managing the project.

A Mudaraba is restricted when the fund provider specifies a particular business or project where the investment funds are to be used. The fund manager is not authorized to use the funds for any other business or project.

A Mudaraba is unrestricted when the fund provider gives the fund manager permission to use the funds for any type of business or project that best suits the financial goals of both partners.

Mudaraba contracts can be used by Islamic Finance institutions to offer different types of products and services.

5.7.6.1. Financing services

Overview of products / services

A restricted Mudaraba can be used where the bank is the fund provider and the customer is the fund manager.

VAT treatment

From a VAT perspective, the share of profit received by the bank (over and above the capital contributed) is considered as profit margin and treated in a similar way to interest income in a conventional lending arrangement. No VAT is therefore applicable on the profit margin received by the bank, as the profit margin is the consideration for a VAT exempt financial service (i.e., the provision of finance), unless it meets the criteria to be an export of services and subject to VAT at the zero-rate.

5.7.6.2. Investment accounts (unrestricted)

Overview of products / services

An unrestricted Mudaraba can be used where the bank's customer is the fund provider and the bank is the fund manager.

VAT treatment

From a VAT perspective, the share of profit received by the customer (over and above the capital contributed) is considered as profit and treated in a similar way to interest income in a conventional savings account. No VAT is therefore applicable on the profit received by the bank's customer.

The bank, as fund manager, will also receive a share of profit and may also charge a fee for managing the contract.

The fee charged by the bank, whether charged directly to the customer or deducted from the profit share to be received by the customer, is the remuneration for a financial service to the customer and is subject to VAT at the standard rate of 5% when supplied in Bahrain (unless it meets the criteria to be an export of services and is subject to VAT at the zero-rate).

The bank's share of profit, earned in an implicit way, is VAT exempt when supplied in Bahrain (unless it meets the criteria to be an export of services and is subject to VAT at the zero-rate).

5.7.6.3. Investment accounts (restricted – segregated and pooled)

Overview of products / services

A restricted Mudaraba can be used where an account holder (i.e., segregated investment account) or a pool of investors (i.e., collective investment scheme) are the providers of funds and the Islamic Finance institution is the fund manager.

VAT treatment

From a VAT perspective, the share of profit received by the provider of the funds (over and above capital contributed) should be treated in the same way as income that would have been earned under an equivalent conventional investment management contract. Therefore, VAT is generally not expected to apply on the profit received by the fund provider.

The share of profit received by the Islamic Finance institution (fund manager), together with the management fee it may charge for managing the contract, are considered as remuneration for the Islamic Finance institution's portfolio management services.

Portfolio management services are financial services and:

- The share of profit, earned in an implicit way, is VAT exempt when supplied in Bahrain (unless the service meets the criteria to be regarded as an export of services and is subject to VAT at the zero-rate).
- The management fee is subject to VAT at the standard rate of 5% when supplied in Bahrain (unless it meets the criteria to be regarded as an export of services and is subject to VAT at the zero-rate).

5.7.7. Wakala

Wakala is a contract of agency or delegated authority in which the principal appoints an agent to carry out a specific task on its behalf.

Wakala can be used by Islamic Finance banks and other institutions to provide mere agency services, as well as to offer investment accounts to their customers.

5.7.7.1. Agency services

Overview of products / services

Under a Wakala contract, the Islamic Finance institution acts as a disclosed agent (i.e., in the name and on behalf of his customer). The agent is therefore not a party to the transaction he is intermediating. Please see Appendix C of this Guide for further detail on the concept of agency and the associate VAT implications.

Wakala contracts can be used in the financial sector (e.g., a customer or a bank using the services of a broker to buy and sell securities or commodities, a bank appointed to issue a letter of credit or to negotiate and arrange a complex financial transaction in the name and on behalf of other banks, etc.).

VAT treatment

The fees and commissions charged by the agent under a Wakala are remuneration for the performance of intermediary / agency financial services (provided the Wakala mandate is in relation to a transaction which is regarded as a financial service).

The agency fees or commissions are subject to VAT at the standard rate of 5% when supplied in Bahrain (unless they meet the criteria to be an export of services and are subject to VAT at the zero-rate).

5.7.7.2. Investment accounts

Overview of products / services

Under a Wakala, the customer (investor) appoints the Islamic Finance institution (agent) in order to invest in Shari'ah compliant investments on his behalf, at a profit rate agreed upfront.

The customer provides the cash (principal) to be invested by the Islamic Finance institution, as his agent, and will receive the agreed profit rate. On maturity date, the customer can take back the principal amount initially provided.

The Islamic Finance institution may charge a fee for its agency services and also retains any profit exceeding the profit rate agreed with the customer.

VAT treatment

From a VAT perspective, the share of profit received by the customer is considered as profit and treated in the same way as interest income in a conventional savings account. No VAT is therefore applicable on the profit received by the bank's customer.

The agency fee charged by the Islamic Finance institution, whether charged directly to the customer or deducted from the profit share to be received by the customer, is the remuneration for a financial service and is subject to VAT at the standard rate of 5% when supplied in Bahrain (unless it meets the criteria to be regarded as an export of services and is subject to VAT at the zero-rate).

The profit share retained by the Islamic Finance institution (where there is an excess after distribution to the client), earned in an implicit way, is VAT exempt when supplied in Bahrain (unless it meets the criteria to be regarded an export of services and is subject to VAT at the zero-rate).

5.7.8. Kafalah

Overview of products / services

Islamic Finance institutions are usually able to offer financial guarantees, letters of credit and securities for money using a Kafalah contract.

VAT treatment

Fees charged under a Kafalah contract for the provision of financial guarantee services, letters of credit and other security for money services have the same VAT treatment as the equivalent conventional banking products.

Please consult section 5.1.5 of this Guide for further details on the VAT treatment applicable to Kafalah.

5.7.9. Islamic bank cards

Overview of products / services

In a similar way to conventional credit cards, Islamic bank cards can also offer a credit facility to the cardholder.

VAT treatment

Financing services offered by Islamic Finance institutions are usually remunerated by way of a profit margin, using notably deferred payment sale contracts or commodity Murabaha / Tawarruq.

The profit is subject to the same VAT treatment as interest earned under a conventional credit card, i.e., it is VAT exempt when supplied in Bahrain (unless it meets the criteria to be regarded as an export of services and is subject to VAT at the zero-rate).

Usually, Islamic Finance institutions will also charge their customers an annual subscription fee for the usage of the card. They will also charge interchange fees to acquiring banks when they act as card issuer in a card payment transaction. If they also offer acquiring bank services to merchants, they will also be entitled to merchant service charges.

For all the services and fees mentioned above please see “Payment related services” under section 5.1.3 of this Guide, as the VAT treatment covered in this section applies in the same manner to Islamic Finance institutions.

5.7.10. Sukuk

5.7.10.1. Issue and redemption of Sukuk certificates

Overview of products / services

A Sukuk certificate is a financial instrument usually compared to bonds in conventional finance. Please see section 5.4.2 of the Guide for further details on the treatment of the issue of debt securities.

Sukuk certificates are issued in order to raise capital from investors in a Shari’ah compliant way, when the capital is to be used by the issuer to purchase an identifiable asset.

The issuer of the Sukuk certificate will make a contractual promise to buy back the certificates at a future date at their face value.

Sukuk certificate holders, who own a share of the asset acquired by the Sukuk certificate issuer, will be entitled to receive a portion of the earnings from the asset during the period they hold the certificate.

VAT treatment

Similarly to the issue of bonds under conventional finance, the issue of Sukuk certificates by a person seeking to raise capital is not a supply for the purposes of VAT. The issue of Sukuk certificates is therefore outside the scope of VAT.

At their maturity date, the Sukuk certificates will be redeemed by the issuer of the certificates at their face value. This redemption is not a supply for VAT purposes. The amount repaid is not consideration for a supply from the holders of the Sukuk certificates to the issuer of the Sukuk certificates.

The redemption of Sukuk certificates is treated in the same way as the repayment of a bond or a loan principal amount. It is out of the scope of VAT.

In order to fulfil his obligations towards his investors, the Sukuk issuer may need to enter into a series of Islamic Finance contracts. Each contract will have to be analysed in order to apply the correct VAT treatment applicable to it.

5.7.10.2. Sale of Sukuk certificates

Overview of products / services

Once issued on the primary market, Sukuk certificates may be traded on the secondary market (e.g., when a Sukuk holder decides to sell his Sukuk certificates).

VAT treatment

Similarly to the sale of a debt security in conventional finance, the sale of a Sukuk certificate by a taxable person is a supply of financial services. As such, it is exempt from VAT in Bahrain unless it meets the conditions to be subject to VAT at the zero-rate (export of services).

Please see section 5.4.4 of the Guide for further details on the VAT treatment of the sale of debt securities.

6. Insurance

An insurance service is a contract which provides cover to the policyholder (the insured) in respect of an uncertain future event. When the uncertain event materializes, the insured (or beneficiary as the case may be) can make a claim against the insurance company.

Under a reinsurance contract, an insurance company seeks to insure, from other insurance companies that offer reinsurance services, its portfolio of existing insurance contracts.

In order to benefit from the cover, the insured will pay a premium to the insurance or reinsurance company.

From a VAT perspective, life insurance and life reinsurance contracts have to be distinguished from other insurance and reinsurance contracts (i.e., general insurance and health). This is because life insurance and life reinsurance contracts are considered as financial services and are VAT exempt in Bahrain. Other types of insurance and reinsurance contracts are subject to VAT (at the standard rate or at the zero-rate in certain circumstances). The approach is to align the tax treatment of Islamic contracts with the conventional insurance contracts that they are economically equivalent to.

As a general comment, which is applicable to all type of cover, insurance and reinsurance services follow the general place of supply rules applicable to services (see Appendix A of this Guide).

All insurance and reinsurance services are generally considered as continuous supplies of services for the purposes of tax due date rules (see Appendix B of this Guide).

6.1. Life insurance and life reinsurance contracts

Overview of products / services

There is no definition of life insurance and life reinsurance contracts in the VAT Law and the Executive Regulations.

For VAT purposes, life insurance and life reinsurance contracts must be understood as:

“A conventional or Takaful insurance contract or other form of Islamic insurance which results in the payment of a sum contingent on death or other significant event of human life.”

In practice, the products licensed by the Central Bank of Bahrain that fall within the category of life insurance products, including any savings and protection elements attached to these policies, are considered to be life insurance for VAT purposes. The definition of “life insurance” under the Central Bank of Bahrain Rulebook is the following:

“Long term insurance means life insurance, personal accident over one year, savings and fund accumulation insurance”.

Life insurance and life reinsurance services are considered as financial services for the purposes of VAT.

VAT treatment

Life insurance and life reinsurance products (i.e., the premium paid) are exempt from VAT in Bahrain, unless they meet the conditions to be regarded as exported services and are subject to VAT at the zero-rate.

The VAT liability of reinsurance contracts must be analysed based on the parties to the reinsurance contract. The location and status of the underlying risk and the persons ultimately insured (i.e., the persons with whom the insurance company has contracted) are not relevant.

Taxable persons are required to issue tax invoices for their supplies in Bahrain. It is therefore expected that a taxable person providing VAT exempt or zero-rated life insurance and life reinsurance services in Bahrain issues tax invoices. The amount to be shown on the tax invoice is the premium.

It may be that additional fees are charged to the policy holders as part of a life insurance or life reinsurance contract such as administration fees and management fees. These fees, whether charged separately to the participants or netted against their premium, are not exempt from VAT. They are subject to VAT at the standard rate of 5% when supplied in Bahrain (unless they meet the conditions to be regarded as an export of services and are subject to VAT at the zero-rate).

The transfer of life insurance and life reinsurance contracts is also considered as a financial service and the VAT treatment will be the one as the provision of the contract itself (i.e., VAT exempt).

6.2. Takaful and re-Takaful (life)

Overview of products / services

Takaful and re-Takaful are mutual insurance arrangements.

The participants make a contribution (donation or “tabarru”) to a Takaful common fund which is operated by the Takaful operator on behalf of the participants. These funds will be used to provide mutual assistance to the participants for specified loss or damage.

The amount of contribution that each participant makes, which is based on the type of coverage they require and their personal circumstances, is the amount paid by the participant to avail of the guarantee that his identified risk will be covered.

VAT treatment

The contributions made by the participants, when they specify a risk falling within the scope of “life insurance cover”, are considered, for VAT purposes, as remuneration for life insurance or life reinsurance services and have the same VAT treatment as premiums paid under a conventional life insurance or reinsurance product.

These contributions, when they cover life, are therefore VAT exempt in Bahrain unless they meet the conditions to be regarded as exported services and are subject to VAT at the zero-rate.

The Takaful operator usually charges fees to cover the management and administration of the Takaful fund. These fees, whether charged separately to the participants or netted against their premium, are not exempt from VAT in Bahrain. They are subject to VAT at the standard rate of 5% when supplied in Bahrain (unless they meet the conditions to be regarded as an export of services and are subject to VAT at the zero-rate).

6.3. General insurance and reinsurance contracts (non-life)

Overview of products / services

A general insurance or reinsurance contract provides cover on assets and liabilities, with the exception of life, for any loss or damage[3]. For VAT purposes, general insurance also covers health insurance.

VAT treatment

When supplied in Bahrain, general insurance and reinsurance services (i.e., the premium paid) are taxable at the standard rate of 5% unless they meet the conditions to be subject to VAT at the zero-rate.

Some insurance and reinsurance services, when supplied in Bahrain, will be subject to VAT at the zero-rate, provided they meet some specific conditions:

- Exported insurance services: any insurance and reinsurance services that meet the conditions to be regarded as exported services will be subject to VAT at the zero-rate.
- Insurance and reinsurance services related to international transport of goods or passengers: insurance and reinsurance services of cargo and passengers are subject to VAT at the zero-rate when the cargo or passengers are transported as part of international transport.

It may be that additional fees are charged to policyholders as part of the insurance or reinsurance contract, for example administration fees. These fees, whether charged separately to the participants or netted against their premium, are subject to VAT at the standard rate of 5% when supplied in Bahrain (unless they meet the conditions to be regarded as an export of services and are subject to VAT at the zero-rate).

Taxable persons are required to issue tax invoices for their supplies in Bahrain, including their zero-rated supplies. It is therefore expected that a taxable person providing standard rated or zero-rated insurance and reinsurance services in Bahrain issues tax invoices.

3 Including: Motor, Property, Accident and Liability, Aviation, Marine (Cargo, Hull) Energy, Engineering, Transportation, Travel, Medical, others

6.4. Takaful and re-Takaful (non-life)

Overview of products / services

The amount of contribution that each participant makes, which is based on the type of coverage they require and their personal circumstances, is the amount paid by the participants to avail of the guarantee that their identified risk will be covered.

VAT treatment

The contributions made by the participants are considered for VAT purposes as remuneration for general insurance or reinsurance services and follow the same treatment as the premiums paid under a conventional general insurance or reinsurance product. These contributions are therefore subject to VAT at the standard rate of 5% in Bahrain, unless they meet the conditions to be subject to VAT at the zero-rate.

The Takaful operator usually charges fees to cover the management and administration of the Takaful fund. These fees, whether charged separately to the participants or netted against their premium, are also subject to VAT at the standard rate of 5% in Bahrain, unless they meet the conditions to be regarded as an export of services and are subject to VAT at the zero-rate.

6.5. Payment of claims

6.5.1. Settlement and indemnity payments

Any settlement made by the insurer in respect of an insurance settlement claim may either be by way of a financial indemnification (for indemnity-based insurance contracts) or in-kind (by way of replacing goods or services).

For VAT purposes, the financial indemnity or replacement made by the insurer in respect of an insurance claim is, in principle, treated as being outside the scope of VAT. This is because the cash payment of the indemnity is not consideration for a supply by the insured to the insurer. Similarly, no consideration is received by the insurer for the repair or replacement of the damaged goods. Thus, indemnity settlements (by way of cash or kind) are outside the scope of VAT.

There may be cases where the indemnity does not cover the full amount and the insured is required to cover part of the costs (i.e., excess cover). The excess to be incurred by the insured is not the consideration for a supply by the insurer to the insured and the insurer is not expected to charge any VAT when it recovers this excess from the insured.

Example

Zee Ltd. ("Zee"), is a company that has a place of residence in Bahrain. Zee has insured its assets, including a building, against fire and destruction with BAS Insurance Ltd ("BAS"), a regulated insurance company based in Bahrain (taxable person).

A fire engulfs Zee's building and 60% of the building is burnt and defaced. After the unfortunate incident, Zee hires a repairer to repair the building. Zee's insurance covers the expenses incurred so as to repair the building (financial indemnity cover). Zee asks BAS for a refund of the costs paid to the repairer. This refund from BAS to Zee is not considered a supply for VAT purposes.

Should Zee have had the option to not advance the payment of the repair costs (e.g., if he had picked a BAS network repairer), Zee may have asked the repairer to send his bill for payment directly to BAS. BAS would have then pay the amount due directly to the repairer and this payment from BAS to the repairer would not be a supply for VAT purposes.

6.5.2. Third party costs

6.5.2.1. Cover with financial indemnity

Where a third party carries out repairs covered by an insurance contract, that third party will generally be considered as supplying his goods or services directly to the insured party (i.e., the insured party is the recipient for VAT purposes). In this case, it is expected that the third-party supplier will issue his tax invoice to the insured mentioned as recipient or "bill to".

Even if the supplies are made to the insured, the third-party provider may request the payment directly to the insurer. This is usually the case when the third-party provider is part of the insurance company's "network" of suppliers. In this case, the tax invoice must still be issued to the insured (as "bill to") but can be sent for payment to the insurer.

If VAT has been charged by the third-party provider on his supplies, this VAT cannot be recovered by the insurer. This is because this VAT does not "belong" to the insurer. Even if the insurer is responsible for payment, it is not the recipient of the supplies made by the third-party supplier. It is therefore not entitled to claim this VAT on its tax return.

The person that is entitled to claim the VAT charged by the third-party provider is the insured (i.e., the recipient of the supplies). This is however subject to:

a) the insured being a taxable person entitled to recover input VAT and

b) the VAT on these expenses meeting all the conditions to be recovered (including being in possession of a valid tax invoice).

Based on the above, the following practical approach may be adopted by insurers:

- The payment made by the insurer to a third-party provider can be made exclusive of VAT when the insured is a taxable person that can recover input tax and is in possession of a

tax invoice from the third-party provider. In this case, the insured can pay the VAT directly to the third-party supplier.

- The payment made by the insurer to a third-party provider is made inclusive of VAT in all other cases

Example 1

C Ltd owns an equipment that broke down stalling the company's operations, requiring immediate repair to allow the company to resume normal operations. The cost of repair is BHD 8,000 (exclusive of VAT), which is fully covered by the general insurance policy with RoS Insurance Ltd.

BX Ltd, the repair company, is instructed by C Ltd and raises an invoice to C Ltd for the repair services for BHD 8,400 (VAT Included).

C Ltd, as the service recipient, pays the VAT amount and transfers the invoice to the insurance company to arrange for direct payment of the VAT exclusive amount.

Example 2

Anisa, a private individual resident in Bahrain, needs to have her car repaired further to a minor road accident. The costs of the repair are covered by Anisa's insurance contract (financial indemnity), with the exception of an excess of BHD 75.

The garage informed Anisa that the total cost of the repair is BHD 525 (including VAT).
Anisa pays the excess of BHD 75 directly to the garage and the garage will ask Anisa's insurance company for the payment of the balance (i.e., BHD 450).

The garage should raise a tax invoice to Anisa for the total costs of the repairs as Anisa is the recipient of the repair services (i.e., BHD 525). Anisa cannot recover the VAT charged on this tax invoice as she is not a taxable person.

When asking for payment of the balance to the insurance company (i.e., BHD 450), the garage must not issue a tax invoice to the insurance company. It must simply request the payment of the tax invoice issued to Anisa.

The insurance company will not be able to recover the VAT charged by the garage on the repair services. This is because this VAT, even if paid by the insurance company, does not "belong" to the insurance company (i.e., the insurance company is not the recipient of the repair services; Anisa is).

6.5.2.2. Cover with replacement

Where the settlement of a claim is made by way of replacement goods or services, the VAT position with regards to the recipient of the third-party provider's supplies will depend upon the terms of the contractual arrangements between the parties concerned.

In normal circumstances, the supply of these replacement goods or services by a third-party provider is seen as being made to the insured.

When goods are supplied to the insurance company for further transfer to the insured in the settlement of a claim, the insurance company should not claim the VAT charged on the supply of these goods. If the insurance company had recovered the VAT, it would in any event be required to account for output tax on the cost price of the goods when the goods are handed over to the insured (i.e., recognition of a deemed supply of goods to the insured).

6.5.3. Recovery of claims

When the risk realized involves two parties and one of them is at fault, it may be that the insurance company of the "not-at-fault" party asks the insurance company of the "at-fault" party to refund (part of) the indemnity paid to the not at fault party.

Recovery of claims by or from a third-party insurer is outside the scope of VAT. This is because the amount paid or received is not consideration for a supply from or to the third-party insurer.

6.6. Insurance intermediaries

In the insurance industry, intermediaries are usually the link between insurance companies and policyholders.

6.6.1. Insurance brokers

A broker usually acts by appointment of a person seeking insurance cover. He will assist his customer in finding the cover which meets the requirements specified and will help the customer with the signature of the insurance contract. He may also help the policyholder with the submission of a claim where needed.

An insurance broker acts in the name and on behalf of his customer when undertaking his tasks. He is regarded as a disclosed agent for the purpose of VAT (Please see Appendix C of this Guide). The broker is not acting as a "principal" in the insurance transaction and is not a party to the insurance contract entered into directly between his customer and the insurance company.

An insurance broker will usually be entitled to receive a commission or a fee for his intermediation services.

The recipient of the broker's services is, in principle, the insured (i.e., the person who appointed him to find the cover). This is still the case even when the person actually paying and bearing the brokerage cost is the insurance company.

When supplied in Bahrain, these intermediation services (i.e., the commissions or fees) are taxable at the standard rate of 5%, unless they meet the conditions for the application of VAT at the zero-rate (export of services). This is regardless of whether the brokerage services relate to general or life insurance.

The provision of a brokerage service would generally be regarded as a one-off supply of services for the purposes of the tax due date rules, depending on the exact terms and conditions of the brokerage contract. Some contracts may qualify as continuous supplies of services under specific circumstances.

When a broker collects the premium from his client (i.e., the insured) to remit it to the insurance company (minus his brokerage fee or commission, which is taxable), he is solely acting as a collecting agent and these payment flows should be disregarded.

6.6.2. Insurance agents

An insurance agent is usually appointed by an insurance company to “distribute” the insurance company’s products. The agent usually acts in the name and on behalf of the insurance company when arranging the insurance contract with the insured.

Like an insurance broker, he acts as a disclosed agent and not as a principal (see Appendix C of this Guide). Therefore, the insurance agent is not party to the insurance contract entered into directly between the insurance company and the insured.

An insurance agent will usually be entitled to receive a commission from the insurance company for his intermediation services. The recipient of the agent’s services is, in principle, the insurance company (i.e., the person that appointed the agent to distribute its products).

When supplied in Bahrain, these intermediation services (i.e., the commissions) are taxable at the standard rate of 5% unless they qualify for the application of VAT at the zero-rate (export of services). This is regardless of whether the agency services relate to general or life insurance.

The provision of an insurance agency service would generally be regarded as a continuous supply of services for the purpose of tax due date rules.

When the agent collects the premium from the insured to remit it to the insurance company, he is solely acting as a collecting agent and these payment flows must be disregarded.

The payment of the agent’s commission by the insurance company is usually done on a periodic basis and in a consolidated way. The VAT Law and the Executive Regulations allows the use of self-issued tax invoices, subject to some conditions (see section 8.6 of this Guide). In case of self-billing, providing all the conditions are met, the insurance company will self-issue the tax invoices (i.e., in lieu of its agent) for the commissions it owes to its agent.

7. Outsourcing

For various commercial and organizational reasons, it is common practice for businesses in the financial services sector to outsource some of their functions (notably back-office and other support functions) to third party suppliers.

In exchange for their outsourced services, suppliers may charge businesses either a flat fee or an amount corresponding to the salary paid for the resources assigned to provide the outsourced services plus a commission.

When supplied in Bahrain, these outsourced services are subject to VAT at the standard rate of 5% and VAT applies on the total amount received by the suppliers from the businesses. For supplies of manpower, this total amount will often be the salary payable by the supplier to its employees together with certain expenses (e.g., visa costs) and a margin.

Example

Bank BH is a taxable person resident in Bahrain. It has outsourced the IT helpdesk for all its offices in Bahrain to Star Offices Ltd, a taxable person in Bahrain.

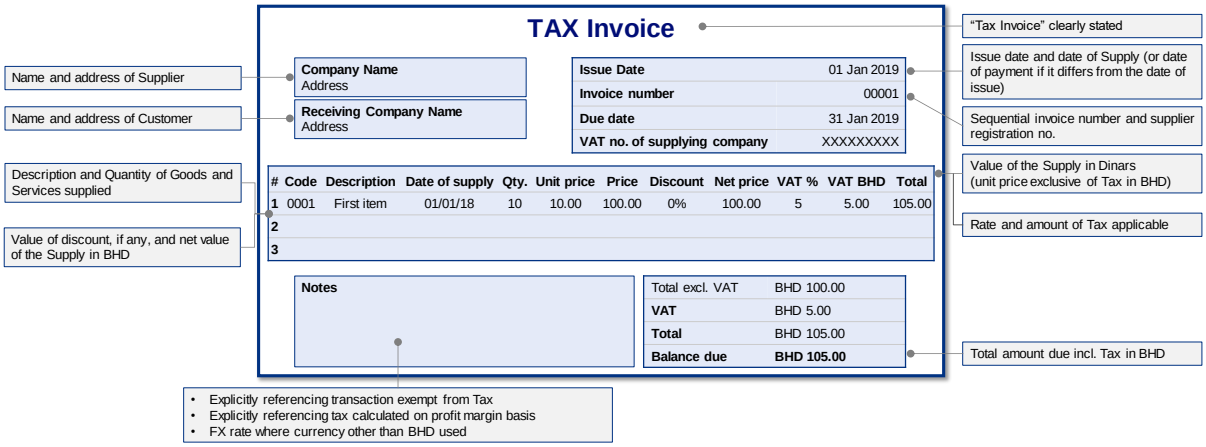
Star Offices Ltd charges Bank BH, on a monthly basis, an amount of BHD 5,000 corresponding to the total salaries paid to the employees assigned to provide the IT helpdesk services plus a mark-up.

Star Offices Ltd provides taxable services to Bank BH and must charge VAT at the standard rate on the total amount received from Bank BH, i.e., 5% on BHD 5,000.

8. Tax invoices

If you are a taxable person making supplies of goods or services in Bahrain, you will be required to issue tax invoices and, depending on the circumstances, other documents. The purpose of this section is to highlight the obligation of a taxable person to issue this documentation together with the requirements that these documents must meet.

Figure 5: Tax Invoice example (illustrative)



8.1. Principles

A taxable person must issue tax invoices in respect of the supplies of goods and services made by him in Bahrain, whether these supplies are made to resident persons or to non-resident persons. Furthermore, a tax invoice must be issued by a taxable person when making a deemed supply of goods and services. A tax invoice must be delivered to the customer.

A tax invoice may be issued in an electronic form or paper form (subject to specific conditions and approval from the NBR).

A tax invoice must be issued at the latest by the 15th day of the month following the month during which a tax due date was triggered. Any delay in the issue of a tax invoice is subject to penalties.

Taxable persons supplying VAT exempt financial services remunerated by way of interest or a margin may choose not to issue tax invoices for these services, provided they are able, upon request of the NBR, to electronically extract and provide the details of their VAT exempt financial services income. The NBR auditors may still audit records through any other means.

The issue of tax invoices is required for the supply of VAT exempt life insurance services.

8.2. Simplified tax invoice

Generally, a tax invoice needs to contain detailed information relating to the supplier, the customer and the supply, as described below. However, a taxable person may issue a simplified tax invoice (which requires less detailed information) in either of the following two situations:

- Where the supply is provided to a person who is not registered for VAT in Bahrain; or
- Where the consideration of the supply does not exceed BHD 500 (inclusive of VAT).

8.3. Requirements for a tax invoice and simplified tax invoice

The list of information to be included on a tax invoice for it to be considered compliant with the VAT Law and the Executive Regulations depends on whether the tax invoice is a full tax invoice or a simplified tax invoice. The table below provides the list of requirements for both a tax invoice and a simplified tax invoice.

Table 8: Information to be included in the tax invoice

Description	Full tax invoice	Simplified tax invoice
The label “Tax Invoice”	✓	✖
The name of the Supplier	✓	✓
The address of the Supplier	✓	✓
VAT Account Number (also referred to as Tax Registration Number (TRN)) of the Supplier	✓	✓
The name of the Customer	✓	✖
The address of the Customer	✓	✖
A Sequential Tax Invoice number	✓	✖
The date of issue of the Tax Invoice	✓	✓
The date of the supply or the date of payment, if different from the date of issue of the Tax Invoice	✓	✖
A description of the supply provided	✓	✓
Quantity of the goods provided	✓	✖

Description	Full tax invoice	Simplified tax invoice
The value of the supply and unit price in Bahraini Dinars (exclusive of VAT)	✓	✗
The value of discounts, if any, and the net value in Bahraini Dinars (exclusive of VAT)	✓	✗
The VAT rate and amount of VAT due in Bahraini Dinar (per line item where the VAT rate is different per line item)	✓	✓
The total amount due, inclusive of VAT, in Bahraini Dinar	✓	✓
The exchange rate applied when a foreign currency is used	✓	✗
Where a transaction is exempt from VAT, it should be clearly stated	✓	✗
Where the profit margin scheme is used, a reference that VAT has been charged based on the profit margin mechanism	✓	✓

8.4. Bank statements

A bank statement issued by a bank can be treated as a valid tax invoice when it contains the following information:

- The name, address and TRN[4] of the bank
- The name and address of the customer
- The date of issue of the bank statement
- The VAT rate applicable for each supply
- The amount of VAT due for each supply

Bank statements treated as tax invoices have to be issued within the deadline for tax invoices, i.e., by the 15th day of the month following the month during which a tax due date was triggered.

8.5. Summarized tax invoice

Where a taxable person makes several supplies to the same customer over a period of time not exceeding one month, he may issue a summarized tax invoice. The summarized tax invoice will be treated as a valid tax invoice provided that all the requirements of a tax invoice are met.

4 VAT Account Number (also referred to as Tax Registration Number (TRN))

8.6. Self-issued tax invoice

In certain cases, the issue of a tax invoice by a taxable supplier may not be practical. In such cases, the taxable customer may issue a tax invoice on behalf of his taxable supplier subject to all of the following conditions being met:

- There is an agreement in writing between both parties allowing the issue of tax invoices by the customer
- The supplier undertakes not to issue any tax invoice when a transaction is subject to self-invoicing
- There is a mechanism whereby the supplier is able to approve every tax invoice issued by the customer on his behalf
- The tax invoice clearly states that it is issued by the customer on behalf of the supplier
- The customer retains a copy of every tax invoice issued on behalf of the supplier
- The invoice issued by the customer on behalf of the supplier meets all the conditions to qualify as a Tax Invoice

Where self-invoicing is used, the taxable supplier remains responsible for the tax invoice issued by the taxable customer.

8.7. Invoices for supplies subject to the reverse-charge mechanism

A taxable person liable to pay Bahrain VAT under the reverse-charge mechanism on a given supply must record the VAT amount due, in Bahraini Dinars, on the invoice issued to him by the supplier. The VAT amount can be written in pen.

8.8. Invoices issued in foreign currency

Where a tax invoice is issued in a foreign currency, the taxable person must convert the amounts stated on the tax invoice to Bahraini Dinars. The exchange rate approved by the Central Bank of Bahrain as at the tax due date must be used.

As a transitional measure, if a Central Bank of Bahrain approved exchange rate is not available, a reliable source of foreign exchange rates should be used. The taxable persons should use the same source consistently until the exchange rates approved by the Central Bank of Bahrain are available.

8.9. Rounding rules

Where the VAT amount due on a tax invoice is a fraction of a Fils of Bahraini Dinar, the value may be rounded to the nearest Fils, based on mathematical rounding rules.

8.10. Adjusting a tax invoice

A tax invoice that has been issued may need to be revised due to changes in the value of the supply. Where the VAT due on the tax invoice is overstated or understated and needs to be amended, the taxable person must make an adjustment by issuing a credit note or debit note depending on the circumstances.

The taxable person needs to maintain adequate records to support these transactions in the event of a future audit by the NBR.

8.10.1. Issue of a debit note

Where a change in a taxable supply leads to an increase in output tax, a debit note must be issued. This may arise where the value of the original supply is amended to a higher value.

A debit note must be issued no later than by the 15th day of the month following the month during which the adjustment was done.

8.10.2. Issue of a credit note

Where a change in a taxable supply leads to a reduction of output tax, a tax credit note must be issued. This may arise where:

- The supply is either returned, cancelled or rejected;
- The original value of the supply is amended (e.g., post-sale discount is provided to the customer because of high quantity purchased over the year, etc.); or
- The supplier adjusted the output tax under the bad debt relief provisions.

A credit note must be issued no later than by the 15th of the month following the month during which the adjustment was done.

8.10.3. Requirements for debit and credit notes

Tax debit and credit notes should contain the following:

- The label “Credit Note” or “Debit Note”, clearly displayed on the document
- The name, address and TRN[5] of the supplier
- The name and address of the customer
- The date of issue of the debit note or credit note
- The sequential number of the credit note or debit note

5 VAT Account Number (also referred to as Tax Registration Number (TRN)).

- The sequential number of the original tax invoice which is being adjusted
- The adjusted value of the supply and the adjusted amount of VAT in Bahraini Dinars

8.11. Intra-Tax Group transactions

Transactions between members of the same tax group are disregarded for VAT purposes. Accordingly, there is no requirement to issue tax invoices for these transactions.

9. Input tax recovery

9.1. Introduction

The purpose of this section is to allow you, as a taxable person, to understand the conditions you must meet in order to be able to recover input tax incurred on your purchases and expenses. This section also covers the various input tax recovery adjustment requirements, including adjustments under the capital assets scheme.

9.2. General principles applicable for input tax recovery

As a general principle, VAT charged on expenses is recoverable based on the use of these expenses:

- VAT charged on expenses used for the purposes of an activity that is not an economic activity as defined for VAT purposes cannot be recovered
- VAT charged on expenses incurred for the purposes of an economic activity can be recovered (in whole or in part) to the extent these expenses are used (in whole or in part) for making taxable supplies (i.e., supplies taxable at 5% or 0%)

The recovery of input tax is subject to conditions that must be met before you may recover this VAT in your VAT return.

9.3. Conditions for input tax recovery

In order to be able to recover the VAT charged on your expenses, you must meet all the following conditions:

- You are a taxable person
- The expenses on which VAT is charged were incurred for the purpose of your economic activity
- The recovery of input tax on the expenses is not specifically disallowed by the VAT Law
- These expenses are used for making taxable supplies (i.e., supplies which are not exempt from VAT)
- You have the supporting original tax invoices which comply with the requirements of the Law or the relevant import documentation
- You claim input tax within the time limit set by the VAT Law, i.e., five years

9.4. Timing for input tax recovery

Input tax on an expense becomes recoverable when VAT becomes chargeable on the supply, i.e., on the tax due date. However, input tax can only be recovered (via the filing of a tax return) when all the conditions for recovery are met. This includes being in possession of an original tax invoice or import documents.

As a result, the recovery position for your input tax on a given expense is the recovery position existing in the tax period (and related annual adjustment where required) where the VAT on this expense became chargeable and payable to the NBR.

This is the case even if you can only formally claim that input tax in the VAT return for a later tax period (when for instance you were not in possession of a valid tax invoice on time to claim it in the VAT return for the tax period where VAT became chargeable on the supply).

Where you did not recover the input tax in the relevant tax period, you are still entitled to claim it within five years from the end of the calendar year where that input tax became recoverable, provided all the conditions to recover that input tax are met.

Example

A bank incurs VAT on a business purchase during a tax period where its input tax recovery ratio was 67% (i.e. due to its partially exempt activities the bank is only entitled to recover 67% of the input VAT on this expense). However, it does not receive a compliant tax invoice for this purchase until one year later, when its input tax recovery ratio is 85% (i.e. at the time it receives the invoice the bank can recover 85% of the input tax on its expenses). The bank can only ask for the recovery of the input tax on this purchase at the time it receives the compliant tax invoice but it should use the 67% recovery rate (which corresponds to the recovery ratio at the time that input VAT became recoverable).

9.5. Methodology to compute the recovery of input tax

The methodology to apply and the rules to follow in order to recover the correct amount of input tax on your expenses is described below.

9.5.1. Identification of expenses used for economic activity vs non-economic activity

Only VAT charged on expenses used for the purpose of an economic activity is considered as input tax and can be included in the input tax recovery computation.

As a result, if you incur expenses used only for the purpose of your non-economic activity (e.g., you hold shares as a passive investment and you incur specific costs for the purpose of this passive shareholding activity), these expenses must be excluded from the recovery computation and the VAT charged on them cannot be recovered.

If you incur expenses which relate to both your economic and your non-economic activities, you are required to apportion these expenses between their economic use and their non-economic use, using an allocation that reflects their fair use. Only the VAT on the portion of the expenses allocated to your economic activity will be regarded as input tax and can be included in your recovery computation.

9.5.2. Input tax disallowed by law

Once you have identified the expenses used for your economic activity, you need to identify, whether the input tax on these expenses is disallowed under the VAT Law and the Executive Regulations.

Input tax recovery is always disallowed when it relates to goods which are illegal to trade in Bahrain.

The VAT Law also lists certain expenses for which input tax can never be recovered. The reason for disallowing VAT on these expenses is generally because these, even if incurred for genuine business purposes, have a significant "private use" element attached to them. Therefore, allowing recovery of input tax on these expenses may lead to final consumption free of VAT.

Table 9: Expenses for which input tax is disallowed by Law

Expenses for which input VAT recovery is blocked	Examples
Input tax paid on entertainment expenses incurred for staff and non-staff members	Accommodation, hospitality, food and drinks when not provided within the course of a meeting or as normal refreshments (for example, tea, coffee, etc.)
Input tax paid for accessing events or functions, and for trips for recreational purposes	Concerts, shows, social dinners or outings, team building events and activities when not provided as part of a business meeting
Input tax paid on goods and services to be used by employees for free for personal use, except when these are required by labour law or other laws in Bahrain.	Providing goods or services for free to employees for them to also use in their private capacity (e.g., mobile phones which can be used for business and private calls, gym subscriptions paid by the employer as part of salary package, etc.)

Expenses for which input VAT recovery is blocked	Examples
Input tax paid on vehicles provided to employees and on related services (maintenance, repair, insurance) to the extent of non-business use of the vehicles and related expenses. The conditions on how to compute the business versus non-business use will be contained in a decision to be issued by the NBR There is no input tax restriction on vehicles and related expenses when the vehicles are for civil defense purposes (i.e., ambulance, fire, police vehicles) or are the taxable person's business tools (e.g., fleet vehicles owned by car rental business, taxis and buses licensed with the Ministry of Transportation and Telecommunications, buses, trucks, cranes or other specific vehicles used for economic activities).	• Purchase or leasing of cars put at the disposal of employees or executives for both business and private use • Repair, maintenance and insurance expenses for these cars The taxable person must identify the non-business use portion on all these expenses and is not permitted to recover the VAT related to this portion.

If input tax on these expenses can be recovered anyway, you would be required to recognize a deemed supply for each of these expenses, resulting in an obligation to pay to the NBR 5% VAT on the value of these supplies.

9.5.3. Direct attribution of expenses to taxable and exempt supplies

Once you have excluded expenses on which you cannot recover input tax under the provisions of the VAT Law, you should identify the expenses which are directly and exclusively used for (or directly attributable to) making either taxable supplies or exempt supplies.

- Input tax on expenses used directly and exclusively for the purpose of making taxable supplies can be recovered VAT in full
- Input tax on expenses used directly and exclusively for the purpose of making exempt supplies cannot be recovered

For the purposes of direct attribution "taxable supplies" include the following:

- Taxable supplies in Bahrain at the VAT rate of 5% or 0%
- Intra-GCC supplies

- Out-of-territorial scope supplies which would be taxable supplies if made in Bahrain (e.g., you held a conference in Spain for which you charged an entry fee)

For the purpose of the direct attribution “exempt supplies” include the following:

- Exempt supplies in Bahrain
- Out-of-territorial scope supplies which would be exempt supplies if made in Bahrain (e.g., you receive rent for a residential property in London)

Based on the above, where your economic activity is fully taxable, you should be in a position to recover in full the input tax charged on your expenses.

If your economic activity is fully exempt, you will not be in a position to recover input tax charged on your expenses.

9.6. Apportionment of input tax on residual expenses

Some taxable persons have an economic activity which is partly taxable and partly exempt (e.g., banks). These persons are referred to as carrying on “partially exempt businesses”. It is expected that some expenses incurred by such persons cannot be directly and exclusively attributed to either their taxable supplies or their exempt supplies. Such expenses are usually called “residual expenses”. To determine the amount of input tax which can be recovered on these residual expenses, an apportionment will be necessary.

The standard method of apportionment is set out in the Executive Regulations and is the method applicable by default to any partially exempt persons. The VAT Law and Executive Regulations also allow the use of special methods of apportionment provided prior approval for their use is obtained from the NBR.

9.6.1. Standard apportionment method

In order to determine the amount of input tax on residual expenses that can be recovered during a tax period, you should apply an apportionment formula which provides the percentage of input tax on residual expenses you can claim. The formula is an allocation between the taxable supplies (sales) and the exempt supplies (sales) of the taxable person for that tax period and is as follows:

P = **A** ÷ (**A**+**B**) where **P** is the percentage of input tax on residual expenses you can claim. **P** should be rounded up to the nearest decimal number.

The total value of supplies, made during the tax period, that allow input tax recovery including:

A. Taxable supplies in Bahrain at the VAT rate of 5% or 0%;
    - Intra-GCC supplies;
    - Out-of-territorial scope supplies which would be taxable supplies if made in Bahrain.
B. The total value of supplies, made during the tax period that do not allow input tax recovery. This includes:

- Exempt supplies in Bahrain; and
- Out-of-territorial scope supplies which would be exempt supplies if made in Bahrain.

The following should not be included when computing the input tax recovery percentage:

- The value of supplies of capital assets used for carrying out the economic activity. Including these supplies may distort the ratio as these are “exceptional” supplies and are not part of the core daily activity of the taxable person
- The value of supplies which are incidental and do not constitute the core activity of the taxable person. Again, including these supplies may distort the ratio as these are “exceptional” supplies and are not part of the core daily activity of the taxable person.

Example

A taxable person whose activity is selling furniture grants a bridging loan to a group company that needs cash at short notice. It earns interest income on this loan. The interest income is exempt from VAT, but should not be included in the value of supplies in computing the input tax recovery percentage as it is an incidental supply.

- The value of supplies made by an establishment of the taxable person located outside Bahrain
- Transactions that do not qualify as supplies for the purposes of VAT (i.e., outside the scope of VAT). These transactions do not fall within the scope of VAT and must not be taken into account to compute the ratio relevant for the apportionment between taxable supplies and VAT exempt supplies. Transactions outside the scope of VAT include notably dividends, accounting adjustments, receipt of indemnity payments and donations (where they are not received in exchange for a specific service or benefit like sponsoring).

Special note for the financial services sector

Regarding financial services, the following has to be kept in mind when computing the input recovery apportionment ratio according to the formula explained above:

- The supplies of assets under any conventional or Islamic Finance asset financing contract (e.g., cars, properties under a hire-purchase contract or an Ijara followed by sale arrangement) must not be included in the computation formula for banks, other financial institutions and any other finance providers.
- The value to be included in the computation formula is solely the interest, profit margin or implicit margin / spread realized for financial services remunerated in this manner.

9.6.2. Special apportionment methods

Alternative apportionment methods may be accepted by the NBR if the taxable person is able to support that the standard apportionment method is impractical, or if the percentage resulting from this standard method does not represent, in a fair and reasonable, way the apportionment between his taxable and VAT exempt activities.

Special apportionment methods can be based on factors relevant to the business such as headcount (e.g., number of staff working on taxable activities compared to the number of staff working on exempt activities) and the number of transactions (number of taxable and exempt supplies, rather than their values).

A taxable person wishing to use a special apportionment method should make an application to the NBR. Until the NBR provides its approval, the taxable person must continue to apply the standard apportionment method.

If the NBR approves a special apportionment method, it will also confirm the effective date for using it and, if relevant, the time limit and conditions associated with its use. If the alternative special method is rejected by the NBR, the taxable person must continue to apply the standard apportionment method.

The NBR may also direct a taxable person to use a special apportionment method where the standard method does not provide a fair and reasonable reflection of the taxable person's economic activity.

9.6.3. Annual adjustment of the apportionment ratio

The apportionment ratio has to be computed by tax period, using the actual values of supplies during that tax period.

At the end of its tax year, the taxable person must conduct an annual adjustment of the input tax recovered throughout the tax year. This is needed to ensure that input tax has been recovered in a consistent way during the tax year and to prevent abuses of the input tax recovery rules.

At the end of its tax year, the taxable person is therefore required to apply the apportionment formula as explained in sections 9.6.1 and 9.6.2 above using the total value of its supplies to total residual expenses incurred during the tax year. If a special apportionment method is used, that method should be applied to the taxable person's total residual expenses for the year.

If the amount of recoverable input tax using the yearly formula differs from the sum of input tax recovered in each tax period of the tax year, the taxable person must make an adjustment of the input tax corresponding to that difference. This adjustment may result either in an additional amount of input tax to be recovered, or in an amount of input tax to be repaid to the NBR.

The annual adjustment should be reported either in the tax return for the last tax period of the tax year or in the tax return for the first tax period of the subsequent tax year.

For the purposes of applying the annual formula, the tax year of a taxable person corresponds to the calendar year (i.e., 1 January to 31 December).

9.7. Adjustment to input tax recovered

There are instances where input tax recovered on expenses has to be adjusted. These are set out in the VAT Law and the Executive Regulations and are summarized below.

9.7.1. Change in the value of the supply received

Where the value of supplies of goods or services received is amended and this triggers a change in the amount of input tax recoverable, the taxable person must adjust the amount of input tax initially recovered.

Such an adjustment is mandatory under the following circumstances:

- Cancellation or refusal of the supply received;
- Reduction in the value of the supply received, after the date of the supply.

In these cases, it is expected that the supplier will issue a tax credit note and the adjustment can be done on this basis.

The adjustment of input tax should be reflected in the tax return for the tax period during which the change in value occurred and the supporting documentation is received.

9.7.2. Failure to pay the consideration for the supply received

The entitlement to recover input tax assumes that the recipient of the supply intends to pay the consideration for the supply. Where the consideration is not paid (in part or in full) within 12 months of the date of the supply and the supplier follows the procedures to obtain bad debts relief, the recipient of the supply is required to adjust the input tax initially recovered by an amount corresponding to the unpaid amount of VAT.

The adjustment of the input tax initially recovered should be reflected in the tax return for the tax period during which the bad debt relief is granted to the supplier.

If, at a later stage, the recipient taxable person pays the consideration due to the supplier (in full or in part), he will be entitled to re-adjust and seek recovery of the input tax paid, in accordance with the input VAT recovery rules, in the VAT return for the tax period during which the payment was finally made.

9.7.3. Change in use - Capital assets scheme

Input tax on purchase of a capital asset

When purchasing a capital asset, a taxable person can recover the input tax paid on this asset based on the use or intended use of the capital asset at the time of purchase:

- Where the capital asset is purchased for making of taxable supplies only, the input tax on this asset is fully recoverable

- Where the capital asset is purchased for making of exempt supplies only, the input tax on this asset is not recoverable
- Where the capital asset is purchased for making both taxable and exempt supplies, the input tax on this asset is partially recoverable

What is the capital assets scheme?

As capital assets are used for a long period of time, their use may change over time. An asset originally bought solely to make taxable supplies could, after some time, be used to make exempt supplies. The taxable person will have claimed 100% of the input tax on buying the asset.

The capital assets scheme is designed to ensure that the correct amount of input tax is recoverable by the taxable person based on the use of that asset over its lifetime, i.e., it is determined by whether it is used to make taxable supplies, exempt supplies or a mixture of both.

Where the use of a capital asset, over a certain time, differs from its initial or intended use, the taxable person is required to adjust the input tax has initially recovered.

What is a capital asset for this purpose?

A capital asset is a tangible or intangible asset that is assigned by the taxable person for long-term use as a business instrument (i.e., it is not stock for sale).

For how long does the capital assets scheme apply?

The capital assets scheme applies during the lifetime of the relevant capital asset which is as follows:

- For intangible assets and movable tangible assets, their lifetime is no less than five years
- For immovable tangible assets, their lifetime is at least ten years

The adjustment period relating to capital assets is:

- Five years for movable tangible capital assets and intangible capital assets
- Ten years for immovable tangible capital assets

The first year of the adjustment period corresponds to the tax year during which the capital asset was first used. Each subsequent year of the adjustment period starts following the end of the preceding tax year. Tax year has the same meaning as for the annual adjustment of the apportionment ratio as discussed at section 9.6.3.

Any change in the use of a capital asset once its adjustment period has expired does not trigger the requirement to adjust the amount of input tax recovered.

Computation of the adjustment

Article 60 of the Executive Regulations provides the step-by-step adjustment methodology as well as the formulae to be used in making an adjustment.

The adjustment under the capital asset scheme, where required, has to be reported either in the tax return for the last tax period of the adjustment tax year or in the tax return for the first tax period of the subsequent tax year.

Maintenance of records relating to capital assets

Taxable persons are required to keep and maintain a record of their capital assets and of the related input tax recovery position throughout the adjustment period.

Input tax on capital assets acquired before registration

Input tax can be recovered on capital assets acquired before a taxable person's effective date of VAT registration. The following conditions are met:

- The capital assets must have a positive net book value on the effective date of registration
- The capital assets must have been acquired or imported by the taxable person for the purposes of his economic activity and there must be a right to deduct input tax, in accordance with the input tax recovery rules.

The maximum input tax that can be recovered is equal to an amount of VAT calculated on the basis of the net book value of the capital assets on the effective date of registration of the taxable person. The net book value is determined in accordance with the accounting practice of the taxable person.

For the purpose of computing the adjustment period applicable to these capital assets, the first year of the adjustment period starts on the date of first use of the capital asset by the taxable person.

A taxable person who wishes to recover VAT on capital assets acquired before registration should provide the NBR with the following documents:

- An inventory of all the capital assets in his possession on the effective date of VAT registration (detailed description, date of purchase and amount of the tax paid);
- Copies of the tax invoices issued by the suppliers;
- Customs declarations for imports.

9.7.4. Cases where adjustment of the input tax is not required

An adjustment of the input tax initially recovered is not required in the following two cases:

- The goods purchased or imported have been lost, damaged or stolen, as long as evidence can be provided of the loss, damage or theft
- The goods purchased or imported have been used to provide low value gifts or samples (see the VAT General Guide on "Deemed supplies" for further information on low value gifts and samples)

10. Tax clarification

While the VAT Law, Executive Regulations and Guides aim to provide clarity on the operation of VAT in Bahrain, there may be instances where some level of uncertainty remains. In such cases, a taxable person (or his tax representative or tax agent) may apply for a tax clarification from the NBR seeking guidance on how to interpret and apply specific provisions of the VAT Law where this is uncertain. A tax clarification should only be sought where the person making the request has carried out detailed analysis on the specific issue and uncertainty remains.

Until the NBR issues a response to a request for tax clarification, it is recommended that the taxable person applies the VAT Law and its Executive Regulations based on the most prudent interpretation.

The NBR will issue guidelines for the tax clarification submission procedure together with the expected timeframes for providing responses.

Appendix A. Place of supply

For Bahrain VAT Law to apply and Bahrain VAT to be charged, a transaction must fall within the VAT jurisdiction or "territorial scope" of Bahrain. It is therefore critical to know where a transaction takes place or is deemed to take place for VAT purposes.

The VAT Law provides for specific rules to be followed so that it can be determined whether a transaction falls within the territorial scope of Bahrain VAT. These rules are commonly referred to as "place of supply rules".

A.1. Place of supply rules for supplies of goods

The VAT Law contains general place of supply rules and special place of supply rules for supplies of goods.

A.1.1. General rules

For goods supplied without transportation and without installation, the place of supply is where the goods are placed at the disposal of the customer. The sale of an immovable property, among others, would follow this rule.

For goods supplied with transportation, the place of supply is where the transport starts. This applies whether the transport is carried out by the seller, the purchaser or a third party on their behalf.

If a supply of goods involves their installation or assembly, the place of supply is where the installation or assembly takes place. For this rule to apply, the installation or assembly must be carried out by the supplier of the goods or by a third party on his behalf.

A.1.2. Special rules

Special rules exist for the supply of water, energy and electricity as well as for Intra-GCC supplies of goods.

These are further detailed in the VAT General Guide.

A.2. Place of supply rules for supplies of services

The VAT Law provides "general rules" and "special rules" for the place of supply of services.

A.2.1. General rules

There are two general place of supply rules for services. These are based on the place of residence of either the supplier or the customer. The key differentiator between these two rules is the VAT status of the customer, i.e., whether it is a taxable person or not.

Place of residence of the supplier

As a general rule, the place of supply of a service is considered to be the place of residence of the supplier.

Place of residence of the customer (taxable person)

Where the customer is a taxable person residing in Bahrain and the supplier is non-resident, the place of supply of the services is the place of residence of the taxable customer (i.e., in Bahrain).

Multiple places of residence

If a person has a place of residence in more than one country, the place of residence used for applying the general place of supply rules is the place of residence most closely connected to the supply of the services.

It is expected that the majority of the supplies of services performed by taxable persons in the financial services and the insurance sectors follow these two general rules.

A.2.2. Special rules

The VAT Law sets out special place of supply rules for services. These rules are summarized below.

Table 10: Place of supply of services

Service	Place of supply
Rental of a means of transport to a customer who is not a taxable person	Where the means of transport is placed at the disposal of the non-taxable customer
Transport of goods, passengers and services related to such transport	Where the transport starts
Restaurant, hotel, catering, cultural, artistic, sporting or recreational events	Where the service is actually performed
Services related to moveable goods supplied by a supplier in Bahrain to a customer which is a not a taxable person in another Implementing State[6]	
Related to a Real Estate	Where the Real Estate is located (see below)
Telecommunication and Electronic services	Where the services are used and enjoyed, to the extent of such use and enjoyment

Services related to real estate

Services related to a real estate are defined in the Executive Regulations. These include accommodation services, services related to construction, services by real estate experts, estate agents, auctioneers, architects, engineers and others who perform tasks and work related to real estate.

These services have to be directly connected to specific real estate. In this regard, real estate is defined as any of the following:

- An area of land over which rights or interests can be created
- A building, structure or engineering work permanently attached to the land
- A fixture or equipment which makes up a permanent part of the land or is permanently attached to a building, a structure or engineering works

Taxable persons in the financial services and the insurance sectors may perform supplies of services following the special rule applicable to real estate related services.

6 Rule not yet operable – will apply when Bahrain recognizes one or more GCC member states as Implementing States

A.3. Place of supply rules for import of goods

The place of supply for import of goods is the first point of entry of the goods in the territory of the Implementing States.

Where goods are placed under a custom duty suspension regime[7] upon entering the territory of the Implementing States, the place of supply for the import of these goods is in the Implementing State where the goods will be shipped to (its final destination) when released from their temporary customs duty suspension regime.

7 For example: Customs warehouse, Temporary admission and Transit.

Appendix B. Tax due date

The tax due date refers to the time when VAT becomes chargeable on a taxable transaction.

This is particularly important in order to determine the timeframe for charging VAT, issuing documentation such as tax invoices, tax credit notes and tax debit notes, reporting in the relevant tax return and payment of VAT to the NBR.

The VAT Law and Executive Regulations set out the general rules in order to define the tax due date for supplies of goods and services as well as the special rules applicable to certain types of transactions. Imports of goods have their own tax due date rule.

B.1. Supplies of goods and services

General tax due date rules

The general tax due date rules apply for all supplies of goods and services unless they fall under a special rule.

For supplies of goods, the tax due date is the earliest of:

- The date of the supply of goods
- The issue of a tax invoice for that supply
- The receipt of a payment for that supply (to the extent of the amount received)

For supplies of services, the tax due date for this supply is the earliest of:

- The date of the supply of the services
- The issue of a tax invoice for that supply
- The receipt of a payment for that supply (to the extent of the amount received)

Special tax due date rules

In certain cases, supplies of goods and services follow special tax due date rules.

Table 11: Special tax due date rules (non-exhaustive)

Supply	Special rule	Example
Continuous supply involving periodic payments or consecutive invoices (see below table for details)	Tax due date is the earliest of: • Date of issue of tax invoice (to the extent of the amount invoiced) • Due date for payment as specified on the tax invoice (to the extent of the payment due) • Date of receipt of the payment (to the extent of the amount received) When none of the above occurs within 12 months of the start of the supply, a tax due date will be triggered at the end of this 12-month period and at the end of any subsequent 12-month periods if none of the above occur in the meantime.	On 5 April, a customer enters into a contract for the provision of water and electricity for his house, with a monthly direct debit on the 15th of each month. A tax due date will be triggered every 15th of each month to the extent of the amount actually paid, unless a tax invoice is issued before that day.
Supply of goods deposited, and supply of goods pledged as collateral	Tax due date is the earlier of: • The bailee or creditor selling the goods • The bailee or creditor deducting a cash amount deposited as a bond in order to definitively acquire the Goods	In January 2019, Company A (bailor) pledges a property in order to be granted a loan with Company B (bailee), a VAT registered company. If Company A defaults and Company B seizes and sells the property, a tax due date will be triggered at the time Company B sells the property.

Supply	Special rule	Example
Operating lease (Contract whereby the lessee benefits from the use of an asset for a specified period of time where, at the end of the lease period, the asset is returned to the lessor and the lessee does not bear any risk related to the ownership of the asset)	Tax due date is the earlier of: • The due date of each instalment under the contract • The date an instalment is paid	A taxable supplier leases a car to a company. The leasing contract signed on 15 September contains quarterly billing with a first payment due on 1 October, and subsequent payments due on 1 January, 1 April and 1 July, each of them for a value equal to three months' rent. The tax due dates are respectively 1 October, 1 January, 1 April and 1 July, unless a payment is received beforehand where the tax due date would be the date the payment is received.
Finance lease (Contract for the lease of an asset under which the lessor transfers substantially all the risks and rewards relating to the ownership the asset to the lessee).	Tax due date is the date of the supply of the goods (Where the contract contains a purchase option exercisable at the end of the contract, VAT becomes due on the purchase value of the goods on that tax due date)	A bank finances the acquisition of a drilling machine under a hire-purchase agreement. The machine is delivered to the customer on 1 February 2019 with instalments to be collected every month until July 2020. The tax due date for the supply of the drilling machine by the bank to its customer is on 1 February 2019, i.e., the day it is put at the disposal of the customer (for the purchase value of the machine).

Supply	Special rule	Example
Deemed supply	Tax due date is: • For goods or services provided for no consideration: where the goods are made available to the third party or where the services have been completed • For goods the taxable person retains upon deregistration: the effective date of deregistration • For transfer of the taxable person's own goods from Bahrain to another Implementing State or vice versa: date of start of the transfer • For the change in the use of a good: date where the change occurred.	Where a company offers awards and gifts to its employees (above the low value gifts threshold), the tax due date will be the date on which the goods are given to the employees.

Continuous supply

A supply is generally considered as continuous when it is provided on a continuous or recurrent basis for a period of time and under terms that provide for the consideration to be determined and / or payable periodically or from time to time.

Continuous supplies are typically supplies which cannot be considered as "finished" or "completed" until such a time that either the contract ends (if the contract is agreed for a specific duration) or one of the parties decides to terminate it (if the contracts is open ended).

Examples of continuous supplies include:

- Membership
- Subscription to a newspaper
- Management services
- Insurance services

- Ongoing / retainer for professional services
- Phone and internet plan
- Recurring delivery of goods under a specific contract (e.g., six-month contract for the weekly delivery of stationery, payable on a monthly basis)

The supply of a specifically agreed project (e.g., a one-off supply such as the delivery of a specific study report or the construction of a specific good) is not, in principle, a continuous supply even if the completion of this project may take a certain amount of time. It therefore follows the general tax due date rules.

However, if the project is subject to staged or periodic payments (e.g., milestone payment per stage of completion) agreed between the parties, the one-off project will be considered as a continuous supply and will therefore follow the tax due date rules applicable to continuous supplies. An example of such projects is an Engineering Procuring Contract (EPC) for the construction of a plant, which envisages completion by phases with milestone payments.

A good supplied with a payment of its price by instalments (with or without an additional financing charge), does not qualify as a continuous supply. This supply is subject to the general tax due date rules. If a financing element is attached to the sale (e.g., credit sale), this financing component will qualify as a continuous supply of services.

B.2. Imports of goods

The tax due date for imports of goods is the date on which customs duties on these goods are due in accordance with the Customs Law (or on the day where they would due where none apply).

Appendix C. Disclosed Agent vs Undisclosed Agent

Where a person acts as an agent or an intermediary, it is important to identify whether he acts as:

- A “Disclosed” Agent; or
- An “Undisclosed” Agent (or “Commissionaire”).

The VAT treatment applicable to each of these agents is very different and is summarized below.

It is therefore critical to identify, based notably on the terms of the existing agreements, whether a taxable person acts as one or the other.

C.1. Disclosed agent

A “disclosed” agent is an intermediary who acts in the name and for the account of another person.

In a supply of goods or services, a disclosed agent can act either in the name and for the account of the “buying” party or in the name and for the account of the “supplying” party.

In any case, the “buying” and “selling” parties know the identity of each other and contract directly between themselves for the supply, while the disclosed agent simply facilitates the conclusion of the contract / supply.

For VAT purposes, there are two separate transactions:

- A supply of goods or services directly between the “supplying party” and the “buying party”; and
- A supply of agency / intermediation services between the disclosed agent and the person he represents (i.e., either the buyer or the seller).

The disclosed agent, taxable person, is liable to apply the correct VAT treatment solely on remuneration earned for his intermediation services (i.e., usually in the form of a commission or success fee). He is also required to issue a tax invoice to the person for whom he acts as an intermediary.

The liability for the supply of goods or services lies directly and exclusively with the supplying party and the buying party.

Example

A private individual wishes to take out car insurance. He asks an insurance broker in Bahrain to provide him with a list of the best insurance products matching his requirements. Once the private individual chooses the insurance policy, the broker assists him with signing the insurance contract. The insurance contract is signed directly between the private individual and the insurance company. The broker will receive a commission (usually a percentage of the premium paid by the policy holder) in exchange for his services.

The broker acted as a disclosed agent, in the name and on behalf of the private individual, in this supply of insurance services. There are two supplies for VAT purposes:

- *A supply of insurance services between the insurance company and the private individual. The insurance company will apply 5% VAT on the premium charged to the private individual.*
- *A supply of intermediation/brokerage services between the insurance broker and the private individual. The broker will apply 5% VAT on his brokerage fee charged to the private individual.*

C.2. Undisclosed agent

An “undisclosed” agent is an intermediary who acts in his own name but for the account of another person. In a supply of goods or services, an undisclosed agent always acts in his own name but for the account of either the person actually supplying the goods or services or the person actually requiring the goods or services.

The undisclosed agent is interposed between the supplying party and the receiving party and these do not know the identity of each other and do not contract directly. The undisclosed agent enters into a contract, in its own name, with respectively the supplier and the buyer.

The undisclosed agent is considered to be acting as a principal in the supply of the goods or services to the purchaser (i.e., “buy-and-sell” arrangement). For VAT purposes, there are two separate transactions:

- A supply of goods or services from the actual supplier to the undisclosed agent; and
- A supply of the same goods or services from the undisclosed agent to the actual customer.

From a VAT perspective, the undisclosed agent will recognize a purchase of the goods or services and an on-sale of these goods or services. Any mark-up applied (if any) by the undisclosed agent when re-selling the goods or services is considered part of the value of the supply of these goods or service (i.e., it is not treated as a separate element from the selling price of the goods or services).

As the undisclosed agent is considered as selling the goods or services to the actual customer, he is, in principle, entitled to recover the VAT charged on these goods or services by the actual supplier (subject to all the conditions being met). It is expected that two tax invoices are issued, one by the actual supplier to the undisclosed agent and another by the undisclosed agent to the actual customer.

Appendix D. Single composite and multiple supplies

If your supply is made of more than one components (e.g., two services or a service and a good), you will need to assess whether your supply is a “single composite supply” or “multiple supplies”.

D.1. Single composite supply

A single composite supply occurs when a supplier provides various goods or services (components) to a customer as a single transaction. Generally, a single fee is charged to the customer for such a supply (with or without a breakdown per component).

There is usually a single composite supply where the transaction is seen by the supplier and the customer as comprising one main supply (i.e., the component the customer specifically sought from the supplier, also known as the “principal supply”) together with other ancillary items which are either necessary or essential for making the principal supply or to help with receiving that principal supply.

Example

A taxable person in Bahrain provides international transport services (by plane) and, as part of the fare, also provides access to business lounge and supply of food and beverages. The lounge and catering services are provided together with the sale of the international ticket (embedded in the business fare) and one charge is made for everything supplied. In this scenario, the international flight is the main or principal supply customers are seeking from the supplier, while the lounge and catering are simply ancillary to the international flight.

On the basis that the different components supplied are considered to form a single supply for VAT purposes, a single VAT treatment will apply to the transaction as a whole. The VAT treatment applicable to the whole supply will be the one of the main component of that supply (i.e., the principal supply). In order to identify the correct VAT treatment, it is therefore critical to identify which component of the supply is the main one.

In the above example, the main component being the international flight, the single composite supply thus follows the VAT treatment applicable to the supply of international transport of passengers.

There is also a single composite supply when it would be artificial to separate between the various components of a transaction, as connecting them gives the transaction its specific character. In this case, the VAT treatment will have to be determined based on the nature of the supply considered as a whole.

D.2. Multiple supplies

There are multiple supplies when a supplier provides various goods or services (“components”) to a customer and each component can be split and “consumed” separately.

In this case, each component can be identified separately and the performance of one component is not necessarily dependent upon or critical to the performance of the other(s).

Generally, even when a single fee is charged, it is possible for the supplier to actually break down this fee against each component without such a breakdown being artificial. The transaction is usually viewed by the supplier as well as by the customer as made of multiple separate supplies which have all been specifically sought by the customer.

Example

An airline company provides international transport services and gives the option to the customers to buy an insurance covering the price of the ticket as well as any other risks or liabilities occurring during the holidays (e.g. medical, legal, cancellation, theft, etc.). Although the insurance is provided together with the purchase of the ticket, it will be considered as a separate supply which is optional ("add-on") and upon which the supply of transport does not depend. In this scenario, the customer is deemed to receive two supplies from the supplier, one of transportation and one of insurance.

Where multiple supplies are performed for the benefit of a customer, the VAT treatment for each supply will need to be considered.

Where a single fee is charged, this fee will have to be split in order to allocate to each supply the relevant portion of the consideration and apply the relevant VAT treatment.

In the above example, the supply of transport will follow the VAT treatment applicable to the supply of international transport of passengers while the supply of insurance will follow the treatment applicable to insurance. The supplier will be required to separately identify the fee to be received for each supply.

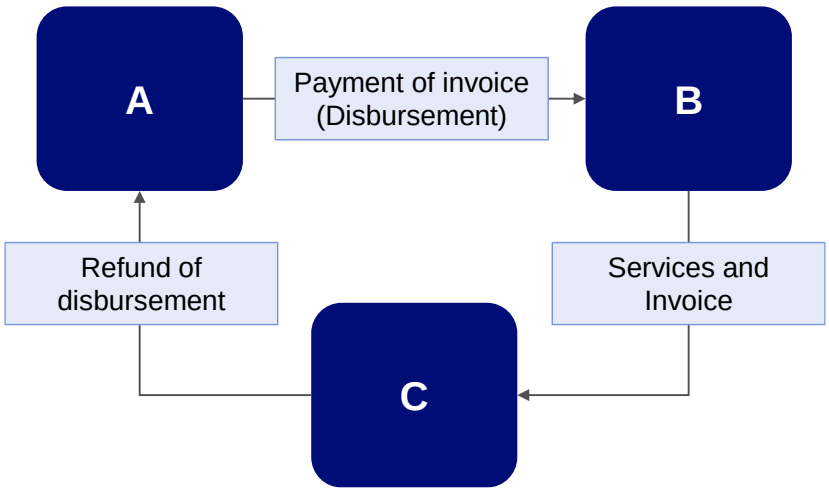
Where the amount invoiced cannot be split and allocated to each separate supply, then the highest rate of VAT shall apply on all the supplies, irrespective of the fact that some supplies should, in principle, be exempt or subject to VAT at the 0% rate.

Appendix E. Disbursements and reimbursements

E.1. Disbursement

A disbursement is a transaction where a person (A) makes a payment to a third party (B) in the name and on behalf of another person (C) and later recovers such amount from C.

Figure 6: Disbursement flow



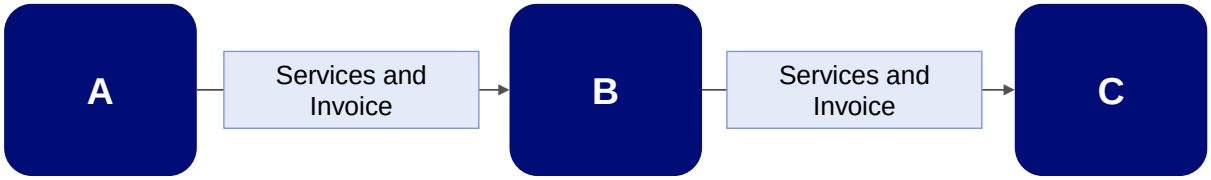
The payment and recovery by A are not supplies falling within the scope of VAT. A is only acting as a paying agent between B and C. The payment flows between A and B and A and C are mere disbursements and are ignored for VAT purposes.

E.2. Reimbursement

A reimbursement is different from a disbursement. For a reimbursement, a taxable person procures a good or a service for its customer and acts as a principal in the procurement chain. The taxable person will procure the good or service from a third party, be invoiced by that third party and will recharge the costs (with a mark-up or not) to its customer.

In this case, the taxable person (B) acts in its own name, as a principal and is buying the good or service from the third party (A) and on-selling it to its customer (C). Therefore, the taxable person (B) is required to charge VAT on its supply to its customer (C) and is also able to recover the VAT charged by the third party (A), subject to the normal input tax recovery rules.

Figure 7: Reimbursement flow



How do I know if it is a disbursement or a reimbursement?

In order to determine whether the transaction is a reimbursement (recharge) of costs or a disbursement, a taxable person should consider the following questions:

- Does he contract with the supplier in his own name or in the name of another person?
- Is he considered as receiving the goods or the services from the supplier?
- Who is legally liable to pay the supplier, i.e., in default of payment, who does the supplier sue?
- Who is the “bill to” person on the invoice issued by the supplier? Is the invoice issued in “care of” person?
- Does he record the payment to the supplier as an expense and the refund from the customer as income in his profit and loss account, or does he simply record a receivable in his balance sheet which is credited when the refund is received?

Appendix F. Fees vs penalties

Suppliers may make charges to customers labelled as “penalties”.

From a VAT perspective, the name given to a charge does not impact its VAT treatment. The VAT treatment solely depends on whether the charge is consideration for a supply of goods or services or is punitive / indemnity in nature. In the former case, the charge will fall in the scope of VAT and the correct VAT treatment will have to be identified while, in the latter case, the charge will be outside the scope of VAT.

The payment of a penalty or an indemnity is generally triggered by one of the parties to a contract breaching his contractual obligations, resulting in a loss or negatively impacting the other party to the agreement. In this case, the party obliged to pay the penalty or indemnity does not receive any supply in exchange for the payment made.

Before concluding that a charge is outside the scope of VAT due to its punitive or indemnity nature, it is critical to assess whether this charge may be paid in exchange for a supply such as, for instance, accepting to terminate a contract earlier than initially agreed or accepting to keep providing a service despite the breach of his contractual obligations by the recipient.

In this respect, the fact that a business may adopt a certain fee structure for the supply of his products with the intention to dissuade or incentivise customers’ specific behaviours does not necessarily make a charge “punitive” in nature.

In any case, any charges made by a supplier to his customer as part of their contractual and commercial relationships require a case-by-case analysis based notably on the contractual terms agreed between them.