



IMPACT OF VAT ON FINANCIAL SERVICES



Introduction

The Member States of the Gulf Cooperation Council (GCC) have signed a Unified Agreement on VAT containing the majority of the regulations for the operation of VAT. Each GCC Member State will complete the rules with their own VAT laws. As Bahrain has just approved the Decree Law on VAT, the content in this newsletter is based on guidelines given under the Decree Law, the Unified Agreement and/or common practices followed by other countries.

VAT Simplified

- VAT is a consumption-based tax levied on every value addition made at each stage of the product cycle.
- The standard rate of VAT as per the Unified Agreement and Bahrain VAT Law is 5%.
- Apart from the standard-rated goods there are exceptions for zero-rated and exempt goods and services. Each State will issue the list of such zero-rated and exempt supplies in its VAT legislation.
- The role of businesses is to facilitate the collection and payment of VAT to the government.
- $\text{Net VAT payable} = \text{Output VAT (due to be paid on sales at a rate of 5\%)} - \text{Input VAT (paid on purchases)}$ In cases where the outcome of this formula is negative, then such net VAT is refundable from the government or can be carried forward to adjust in the next VAT return.

Financial Services in Bahrain

Industry Overview

Bahrain has a strong position in the financial services industry in the GCC, and financial and banking companies play a significant role in the market capitalisation of the Bahrain Bourse. Bahrain has recently experienced a surge in entrepreneurship and start-up businesses.

More information on the impact of VAT on the Bahrain financial services sector will be available once the executive regulations are issued.

Specific Considerations for the Financial Services Industry

Classification- The VAT classification of the various products offered by financial institutions among the different VAT categories is complex. However, the global trend in this regard, as followed by other VAT jurisdictions, is that the fee-based services are taxable and margin-based services are exempt. Bahrain, KSA, and UAE have all adopted a similar treatment where margin-based services are exempt and fee-based services are taxed at the standard rate of 5%. However, there are certain exceptions to this general rule.

Bundles & Mixes- Financial institutions often come up with bundled products where certain add-ons are provided along with the main product. In these cases, each bundle of financial services contains both taxable and non-taxable products. This complicates the process of calculating VAT, particularly the deductibility of input VAT. For example, the margin on financial derivatives in a portfolio is exempt but the investment management fees for the portfolio manager are taxable.

Unallocated Costs- Another disadvantage of exempt items for financial institutions lies in the loss of the right to claim a full deduction of the VAT on those unallocated costs. Most of the outsourced services, such as accounting, transaction processing and IT services, are subject to VAT, but are not directly allocable to a single type of supply (i.e. taxable and exempt supplies). Hence, the input tax incurred is not fully deductible, as the services are utilised for both taxable and exempted operations.

Cross-border Service Transactions– Imported services, i.e. services received by a company in Bahrain, KSA, or UAE by a foreign company, must be accounted for using the Reverse Charge Mechanism. If the service purchased is allocated to exempt supplies then the output VAT must be calculated on the invoice received, and paid to the Tax Authorities. There is no input VAT to be deducted. If the services purchased are allocated to taxable supplies then the same amount must be declared as output and input VAT. The services supplied by a company to GCC countries would, if not exempt, be subject to reverse charge by the business customer. Services supplied to foreign countries would be zero-rated.

Invoicing– Due to the large volume of small-value transactions in financial institutions, compliance with invoicing requirements can prove to be a burden. This increases the non-compliance risks. KSA and UAE laws provide a few alternatives which may ease the burden of issuance of invoices. The executive regulations for Bahrain may provide better guidance in this regard.

General Considerations

VAT Grouping– Related businesses have the option to register as an individual taxable person depending on the individual business structure and environment. Before opting for group registration, businesses should carefully consider both the expected outcomes and issues associated with VAT grouping. VAT grouping can have an advantageous effect on financial institutions if the group is well organised.

Human resources– Where it is common practise to provide benefits such as gifts, memberships, and other perks to employees, the implication of VAT on such benefits will be a matter of concern to employers under VAT laws.

Contracts– Businesses should consider revisiting their existing contracts to update or include VAT related clauses.

Why You Need To Start Preparing for VAT Today

A full-fledged, effective, robust and comprehensive VAT implementation takes ample time from planning to execution. Early preparation is recommended, as a short time span to implement VAT may result in an enormous burden on the company and its resources.

Our Services

VAT Implementation

RSM's VAT advisory services focus on understanding our client's activities and needs. This culture leads to developing a more strategic approach to VAT and creating opportunities to measure and improve efficiency our client's processes. Our methodology protects our clients from overstated tax liabilities, interest charges, and heavy penalties; and helps them, on a long term view, to control VAT liabilities. We advise our clients to proceed with a VAT assessment at the earliest to avoid a last minute panic.

Post Implementation Support

We provide our clients with on-demand technical support in the frame of a pre-established budgetary framework.

Customised Training

We design customised VAT training sessions focused on the client's business activities and on the day to day concerns of the internal VAT stakeholders.

Complete VAT Audit

We propose a VAT audit to anticipate tax audit drawbacks and to evaluate the accuracy of the VAT implementation done by the business itself.

VAT Record Keeping

The VAT record keeping process will become key for the VAT safety of businesses.

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