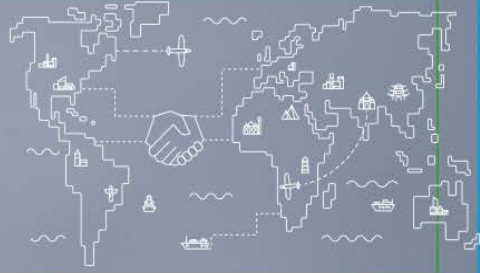


# IMPACT OF VAT ON THE INDUSTRIAL SECTOR



## 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.
- Net VAT payable = Output VAT (due to be paid on sales at a rate of 5%) – 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.

## The Industrial Sector in Bahrain

### Industry Overview<sup>1</sup>

In recent years, Bahrain has prioritised the expansion and upgrade of its industrial zones, which are the main operational location of the Kingdom's industrial and multinational companies. With significant investment taking place across industrial activities and an increasing number of international companies setting up shop in the Kingdom to take advantage of its location and favourable FTAs, the manufacturing industry looks to be in a good position for the medium term.

Moves by the authorities to expand and upgrade the infrastructure of the Kingdom's industrial zones will also be welcome news to investors. As with any sector, diversification brings economic stability and encourages the entry of more companies. The growing focus on lighter industries, FMCGs and pharmaceuticals bodes well for Bahrain in this regard; however, it is likely that a more open environment will bring demand for more industrial land.

## Specific Considerations for the Industrial Sector

**Reverse Charge Mechanism**– The GCC VAT Agreement allows for the concept of Reverse Charging VAT in order to simplify trade between Member States. The Reverse Charge moves the responsibility for the reporting of a VAT transaction from the seller to the buyer of a good or service. This reduces the requirement for sellers to register for VAT in the country where the supply is made. When a transaction is subject to Reverse Charge, the recipient of the goods or services reports both their purchase (input VAT) and the supplier's sale (output VAT) in their VAT return. These two declarations offset each other from a cash payment point of view, but the authorities have full visibility of the transactions. Most sales between GCC Member States will be subject to a reverse charge. There are also several instances where a domestic reverse charge rule exists within specific Member States.

**Utilities– special case:** There are special rules pertaining to the supply of utilities such as gas, oil, water, and electricity. As per the Unified GCC Agreement, the place of supply of such utilities to a taxable trader in another Member State is the country of the taxable trader. In instances where the recipient is not a taxable trader, the place of supply will be the place of actual consumption. As per the Bahrain law, crude oil, gas, and oil derivatives will be zero-rated.

**Imports and Exports**— Industrial businesses should be mindful towards the place of supply rules since they are likely to have numerous cross-border transactions. The general rule is that imports are charged at the standard rate of 5% and exports are zero-rated. This is true for Bahrain, KSA, and UAE. Imports may be subject to a reverse charge as explained previously.

**Toll Manufacturing**— In toll manufacturing, one company provides raw materials or semi-finished goods to a third-party, who will then provide the rest of the services (manufacturing). Typically, the third-party company will already have particular equipment and organisational models in place, and they can supply subclasses of manufacturing processes for the first company for a fee – or toll. This toll is classified as a service for the purposes of VAT and so VAT rules must be applied. In the case of international toll manufacturing transactions, however, the value of goods is not taxable. Neither the transfer of raw material nor the finished goods are taxable, however, the service fee will be subject to VAT.

## General Considerations

**VAT Grouping**— Related businesses have the option to register as an individual taxable person depending on the individual business structure and environment. The main purpose of a VAT group is to disregard the intercompany transactions from a VAT standpoint, and to increase the deduction right of companies carrying out fully or partially exempt activities. A great deal of attention must be paid to the organisation of the group and to the internal implementation of the tax group processes to maximise the benefit and effectiveness of the VAT group.

**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.

## Contact Us

### RSM Bahrain

3rd Floor, Falcon Tower, PO Box 11816, Diplomatic Area, Bahrain

T +973 17537787

F +973 17537757

E [info@rsm.bh](mailto:info@rsm.bh)

[www.rsm.bh](http://www.rsm.bh)



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