



IMPACT OF VAT ON REAL ESTATE ACTIVITIES

Introduction

The Member States of the Gulf Cooperation Council (GCC) have signed a Unified Agreement on VAT containing the majority of the regulation 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 or common practices followed by other countries.

VAT in Simple Terms

- 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 exempted goods and services. Each State will issue the list of such zero-rated and exempted supplies in its VAT legislation.
- Businesses only facilitate in 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.

Construction and Real Estate Industries in Bahrain

Industry Overview

Real estate has long been a mainstay of Kuwait's non-oil economy, while its construction industry is among the strongest in the region and a rising star in the non-oil economy. Kuwait's growing population, tightly regulated land market and wealthy populous all combine to fuel demand for new buildings.

Specific Considerations for the Real Estate Industry

Residential vs Commercial: As per the Unified Agreement on VAT for the GCC, real estate comes under the category for which the Member States have the option either to tax at the rate of 5% or 0% or to exempt. KSA has decided to exempt the supply by way of lease of Residential Real Estate only. All the other operations are taxable at the standard rate. In UAE, the list of exempt supplies is broader: sale of bare land, lease or sale of residential real estate. Furthermore some other operations are zero-rated: the first sale or lease of residential buildings within 3 years of its completion, the first sale or lease of buildings converted from non-residential to residential, the sale or lease of buildings specifically designed to be used by Charities. Concerning Kuwait since no draft regulations are available, no anticipation can be done on the future VAT regime. However the main VAT principles should apply.

Input credit: In cases where the sale of residential property is exempt, the developers/construction companies are likely to face the issue of claiming input tax credit on such exempted properties. This would result in blockage of input credit for such developers/-construction companies, as input VAT on costs related to exempt supplies is not deductible or refundable.

Apportionment – It is common for developers to build mixed-use accommodation for both commercial and residential use. The apportionment of input credit in such case would be a challenge.

Transition period– The projects falling under the transition period will face issues with respect to the extent to which VAT is applicable. The Law and the Executive Regulations provide guidelines on the segregation of work during the transition period and contracts signed prior to issuance of the Law.

Time of supply – Determining the time of supply is important for each transaction under VAT as it forms the trigger point for levying of VAT. For the contracting industry, it might be challenging to identify such time of supply. For instance the VAT is due on each payment received even though the invoice is not issued yet.

Retentions – Another common practice in the construction industry is the retention fee period whereby even after the project is completed, the client holds back a specified amount and release it only after the fulfillment of various conditions set among the parties. Since the supply has been done and the invoice issued, the amount of VAT on such retained fee must be paid to the Government even if the client has not paid yet.

General Considerations

VAT Grouping: It is an option wherein related businesses could register as one single taxable Person under VAT depending on individual business structure and environment. The main purposes of a VAT group is to disregard the intercompany operations on a VAT standpoint and to increase the deduction right of companies carrying out fully or partially exempt activities. Hence, groups having both activities residential and commercial must seriously consider this option. Great attention must be paid to the organization of the group and to the internal implementation of the tax group processes to benefit safely of the effectiveness of a VAT group.

Human resources: It is a common practice to provide various facilities to employees in lieu of the salaries, such as accommodation, gifts, perks etc. The levy of VAT on such facilities is subject matter of concern for employers.

Contracts: Each business should consider revisiting their existing contracts to update or include the 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 service offerings

VAT IMPLEMENTATION

- VAT Awareness
- Assess Impact on Business
- Gap Assessment of IT systems
- VAT Implementation
- Ongoing Compliance Services
- Technical Consulting

Post implementation VAT subscription

In the frame of this subscription, we provide our clients with constantly available technical support in the frame of a pre-established budgetary framework.

Flash VAT audits

Post implementation, we also perform flash VAT audits on various specific items.

VAT Audit trail and VAT internal manual

The documentation of the VAT audit trail is the most reliable methodology to ensure VAT compliance to avoid systemic risks in case of VAT audit

Customized training

We build specific VAT trainings focused on the activity of the company and on the day to day concerns of the internal VAT stakeholders.

Tax/VAT archiving processes

The tax/VAT archiving processes will become key for the tax/VAT safety of the companies.

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