KINGDOM OF BAHRAIN

VAT FINANCIAL SERVICES GUIDE

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VERSION 1.3

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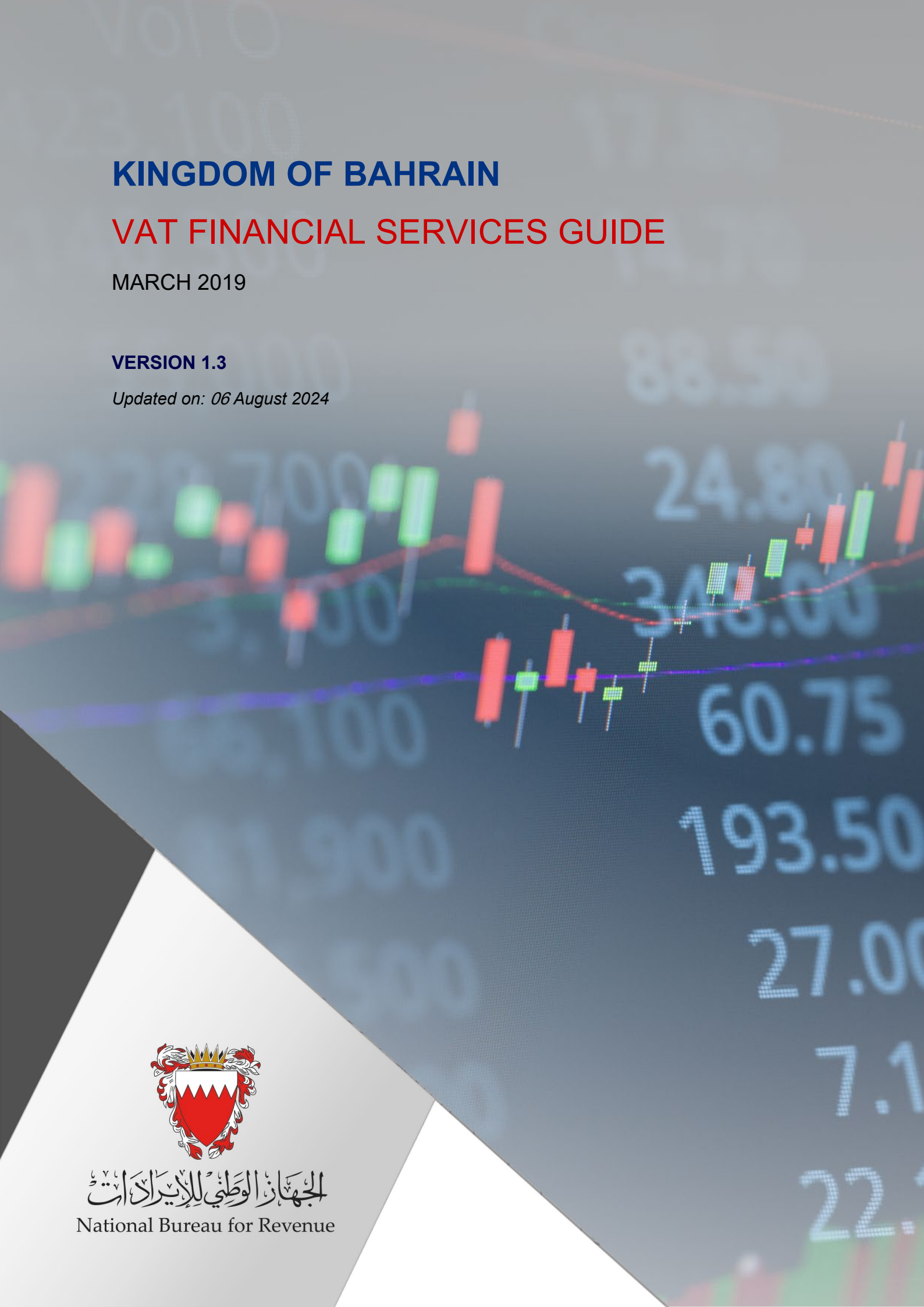

الجهاز الوطني للإيرادات

National Bureau for Revenue

Preface

This document sets out the general principles relating to the treatment of financial services under the VAT system of the Kingdom of Bahrain (Bahrain).

VAT was introduced in Bahrain with effect from 1 January 2019 with a standard rate of VAT of 5%. With effect from 1 January 2022, the standard rate of VAT was revised to 10%. See the VAT Rate Change Transitional Provisions Guide on the NBR website (www.nbr.gov.bh) for an explanation of the transitional rules relevant to the change in rate.

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. This guide is not a legally binding document, it should be used as a guideline only and is not a substitute for obtaining competent legal advice from a qualified professional.

The main principles of the VAT system in the Kingdom of Bahrain are set out in the VAT General Guide issued by the NBR which is available on the NBR's website, www.nbr.gov.bh. This document should be read in conjunction with the VAT General Guide.

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Updates to this guide

Version 1.1	**1 January 2022**	**Section 2.9** VAT treatment of cryptocurrency transactions
Version 1.2	**14 June 2023**	**Section 1.6** Supply of investment grade gold
Version 1.3	**6 August 2024**	**Section 2.7.2** Interchange fees **Appendix F** Fees vs penalties

1. Overview

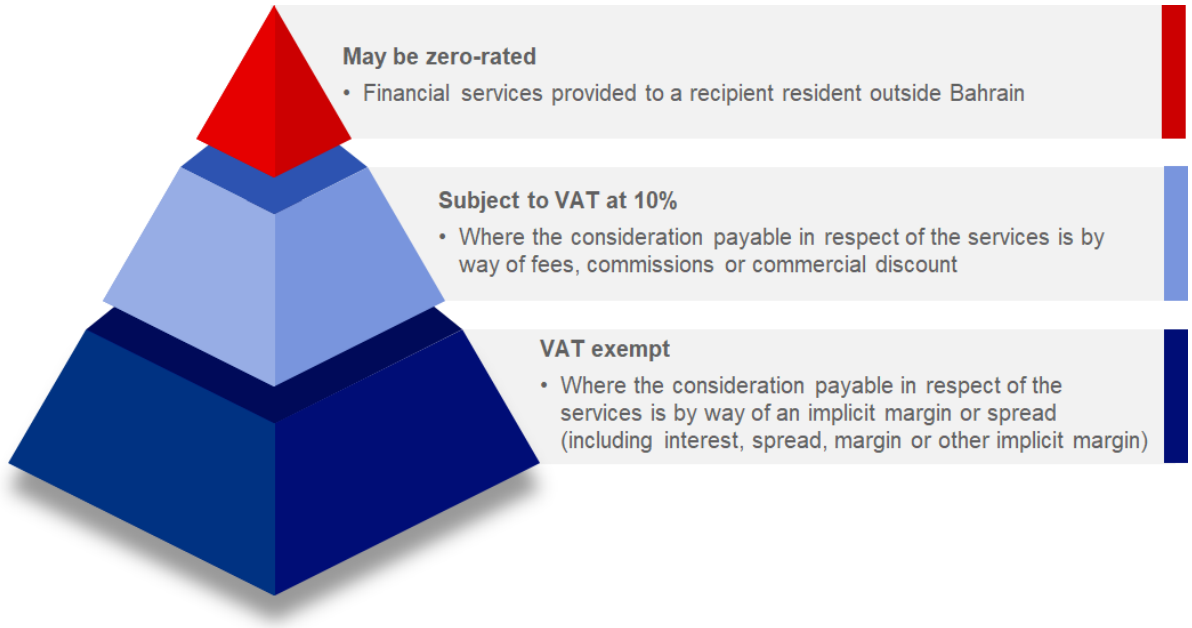
1.1. Overview of the VAT treatment

Under the VAT Law and the Executive Regulations, services falling within the meaning of 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 10%. 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.



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

When a supply is subject to VAT, this means that VAT is chargeable on the supplies made (either at 10% or at 0%). Consequently, VAT charged on expenses incurred by the supplier when making these supplies can be recovered.

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

Please consult section 13 for further details on the recovery of input VAT.

1.2. 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 below.

Service type	Overview	Examples
Money related services	• Services typically performed by banks or similar organizations 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, dishonored 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 • 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	• Issue and sale of shares, bonds

Service type	Overview	Examples
	ownership of a debt or equity security (whether listed or unlisted)	• 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 intended objective and materially achieve the same result	• Murabaha • Commodity Murabaha / Tawarruq • Ijarah / Ijarah followed by a sale • Musharaka • Mudaraba • Wakala • Kafalah • Islamic bank cards • Sukuk
Insurance and life reinsurance	• Provision or transfer of ownership of a life insurance or reinsurance contract	• Provision of life insurance / reinsurance cover or life Takaful / re-Takaful • Transfer of life insurance / reinsurance contracts

Service type	Overview	Examples
	• The provision of insurance cover or an annuity under any investment scheme	• 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 VATable person.

Example 1

A VATable 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 the application of an interest rate which is disclosed and charged separately from the acquisition price of the goods.

The retail store, which is providing credit to its customers for payment of a specific consideration (i.e. 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.

1.3. 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 10%.

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 VATable person established in Bahrain, offers foreign currency exchange services to customers in Bahrain for 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 10%*
- *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 Bahrain real estate 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 repayable principal amount) as well as an arrangement fee (payable upfront for arranging the financing).

- *The arrangement fee charged to the customer is subject to VAT at the standard rate of 10%*
- *The capped interest rate applicable on the repayable 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, the exemption applies regardless of the form of consideration:

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

For the above transactions, 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.

1.4. Islamic finance

For the purposes 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 0.

1.5. Export of financial services

Financial services supplied by a VATable 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 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.

VATable persons who export financial services do not charge an actual amount of VAT on their services, but are entitled to recover VAT charged on the expenses they incur for providing these services.

Example 1

Fuad, an individual whose place of residence is the UK, engages a broker established and registered for VAT in Bahrain to acquire stocks of a company listed on Bahrain Bourse. The broker receives the order on 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.*

Based on the above, the brokerage services should meet the conditions to be "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 10%, which would have been applicable if the services were not "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 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.*

Based on the above, the sale of the shares should be "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 were not "exported" services.

1.6. Zero-rating of precious metals

The supply of gold, silver and platinum is zero-rated in either one 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 grade gold: Investment grade gold is a metal with purity of not less than 99% and in a regular form/ shape (e.g. bars in regular shapes, metal coins). This will not apply to gold that is not in a regular form/ shape such as jewellery.
- The supply of investment silver or platinum: Investment silver and platinum are metals with purity of not less than 99%, which are tradable in the global bullion market and certified by the Ministry of Industry and Commerce (MoIC) or by any entity licensed by the MoIC.

The supply of metals which do not qualify under one of the cases above will be subject to VAT at the standard rate of 10% unless it falls under another specific zero-rating regime (e.g. zero-rated export of goods).

2. Money related services

2.1. Introduction

This section will provide guidance on the VAT treatment applicable to money related services when supplied in Bahrain by a VATable person. For further information on the rules to determine the place of supply and the VAT 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. The correct VAT treatment of services provided should, at all times, be assessed and determined based on the specific terms and conditions of the relevant contracts, as these may differ from the generic services covered in this Guide.

2.2. Operation of bank accounts

2.2.1. Overview of products / services

These are services typically performed by banks and similar organizations in connection with the operation of current, deposit or savings accounts. Services of operating bank accounts include the following:

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

2.2.2. 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 10%, 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 be treated 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 be a continuous supply of services for the purposes of the VAT 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 be one-off supplies of services for the purposes of the VAT due date rules.

In all cases, 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.

2.2.3. VAT treatment of interest earned on bank deposits

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

Interest income earned by a VATable person on his bank deposits is generally considered outside the scope of VAT (as opposed to VAT exempt). This is because the VATable 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 VATable 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 VATable 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 for exports of services).

2.3. Transfer of money and related services

2.3.1. Overview

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 offering money transfer services (local and international) 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.

2.3.2. 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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Transfer / remittance services should, in principle, be one-off supplies of services for the purposes of the VAT 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 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 his 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 to 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.

2.3.3. 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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Whether correspondent bank services are 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 be exported services are met. Where the conditions are not met, such charges are subject to VAT at the standard rate of 10%.

In order to apply the correct VAT treatment to their correspondent bank services (i.e. 10% 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 10% under the reverse-charge mechanism, when the Bahrain resident banks are VATable persons. The Bahrain resident banks are therefore expected to self-account for VAT in Bahrain at the rate of 10% 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 VATable services (e.g. international transfer services).

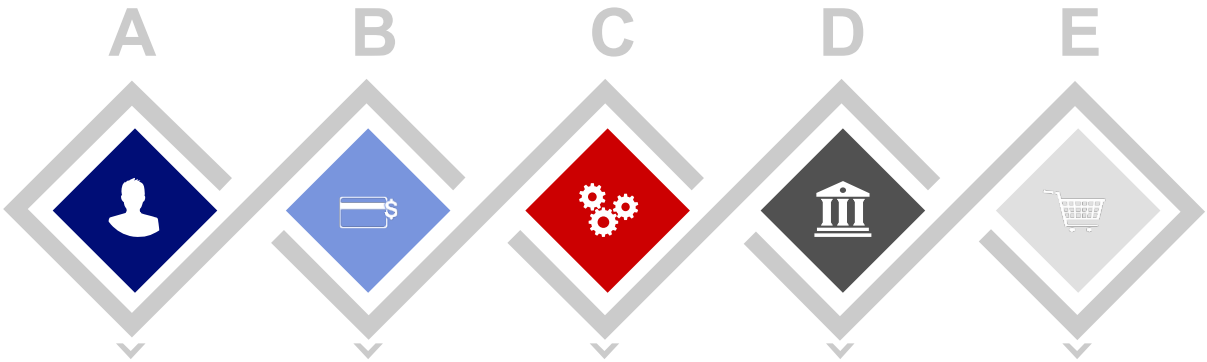
The above treatment is based on the assumption that the Bahrain resident banks contract with the foreign correspondent banks in their own name and act as principal when supplying and receiving the services to / from their correspondent banks. Please see Appendix C of this Guide for further detail on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

2.4. Payment related services

2.4.1. Introduction

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. The main actors involved in payment related services are:



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

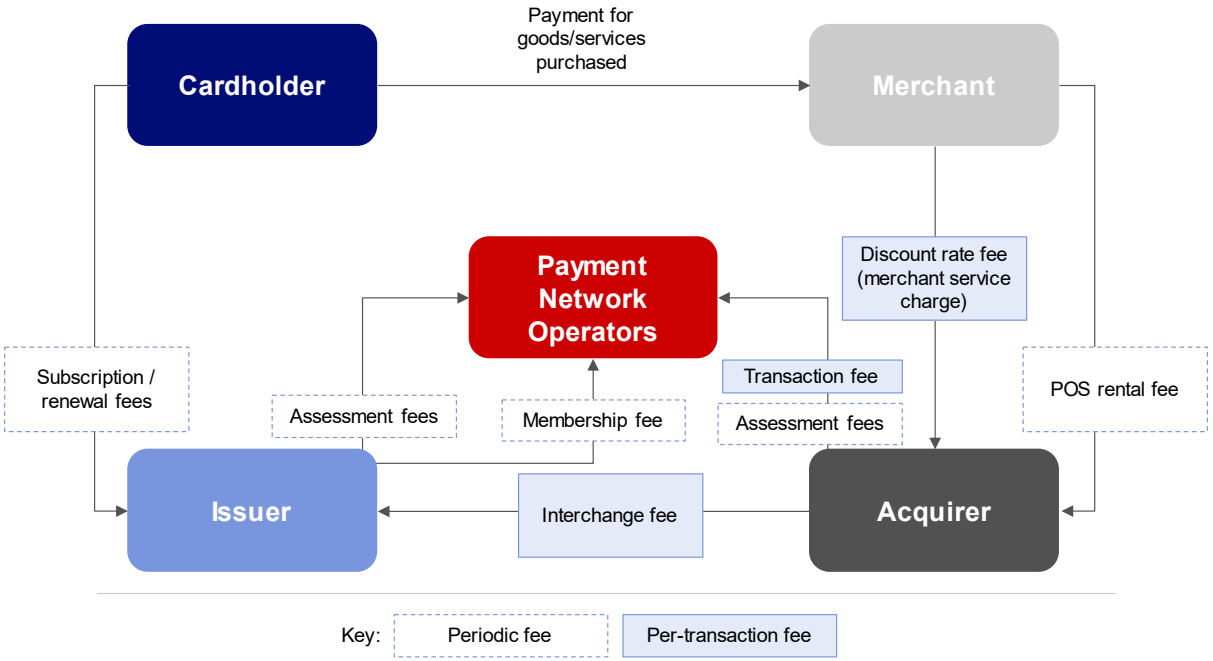
ACQUIRER

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

Typical fees for payment related services are:



2.4.2. Payment Network Operators

Overview of products / services

Their main services usually consist in granting banks and other financial operators access to / membership of 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 10%, 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 VATable persons resident in Bahrain (e.g. issuers and acquirers), these members are expected to account for 10% VAT under the reverse charge mechanism. This VAT can be recovered if it is used by the members for making VATable supplies.

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

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

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

It is critical for issuers and acquirers to look at their existing arrangements with the respective payment network operators to determine the relevant VAT due date rules applicable to the various services and fees covered under these arrangements. A summary is set out below.

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

2.4.3. Issuers

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.

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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Card issue and renewal services should be 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.

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

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.).

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

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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

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

A summary of the VAT treatment for issuers is as follows:

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

2.4.4. Acquirers

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. Acquirers will usually provide various services to merchants.

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 10%, 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 be 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 10%. It is not expected that such services could be zero-rated exported services when the rented terminals are located in Bahrain.

Point-of-sale rental services should be 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 on their exact features, may be 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 10%.

Whether payment gateway services are 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 10% unless the conditions to apply the zero-rate of VAT (for export of services) are met.

Whether such services are 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 10% unless the conditions to apply the zero-rate (for export of services) are met.

Whether such services are 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.

A summary of the VAT treatment for acquirers is as follows:

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

2.4.5. 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.

See the VAT Retail and Wholesale Guide for further guidance on the VAT implications of loyalty schemes.

2.5. Foreign exchange

2.5.1. Introduction

Foreign exchange activities can be broken down into two categories:

- Currency exchange services
- Foreign currency trading

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

2.5.2. 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 10% 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 VAT due date rules.

VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide for further detail). VATable persons are required to issue VAT invoices for the VATable fee or commission charged in consideration for their exchange services.

For zero-rated and exempt financial services remunerated by way of interest or a margin, VATable persons may choose not to issue VAT invoices provided they are able, upon request of the NBR, to electronically extract and provide the details of their zero-rated and 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 charges the customer a commission of 1.5% of the converted amount 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 10% on the commission and will have to issue a VAT invoice for this commission.

The margin realized will be VAT exempt and the Bureau de change will not be required to issue a VAT 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 VAT recovery position

For the purposes of input VAT recovery and the computation of the residual input VAT apportionment ratio under the standard method (see section 13.6 of this Guide), the values to be taken into account are the following:

- All the fees and commissions charged for the foreign exchange services; and
- The net result of the currency buy-and-sell transactions realized during the VAT 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 10% when supplied in Bahrain.

2.5.3. 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.

VATable 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 VAT due date rules.

VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide).

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

Input VAT recovery position

For the purposes of input VAT recovery and the computation of the residual input VAT apportionment ratio under the standard method (see section 13.6 of this Guide), the value to be taken into account is the net result of the currency buy-and-sell transactions realized during the VAT period.

Cases where foreign exchange transactions are not supplies for VAT purposes

There are instances where a VATable 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 VATable 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; and
- 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, which is a VATable person resident in Bahrain, has a treasury function which is in charge of placing the company's funds surplus to generate additional income. The treasury department uses some of the funds to trade in foreign exchange currencies with the intention of realizing margins.

The construction company is actively seeking the realization of income (by way of spread) by entering into foreign exchange currencies trades. It is thus carrying out 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 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 VAT treatment set out in section 2.5.2 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 to be 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 10% 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 VAT due date rules.

2.6. Financial guarantees and security for money

2.6.1. 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, travelers' 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 VATable 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.

2.6.2. 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 10%, 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 VAT 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 3.2 of this Guide) and will therefore be VAT exempt unless it is zero-rated (when it constitutes an export of services).

Guarantee, letters of credit 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, for 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).

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).

2.7. Automated Teller Machines (ATMs)

2.7.1. 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 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 10%. These services would generally be one-off supplies of services for the purposes of the VAT due date rules.

2.7.2. Interchange fees

Generally, Interchange fees are amounts paid by the retailer's bank (Acquirer Bank) to a card holders bank (Issuing Bank) for the service provided by the issuing bank. Interchange fees are also charged by banks when their customers use other bank's ATM facilities, they are usually levied on a transaction-by-transaction basis.

When a cardholder uses his card to make a purchase, the retailer submits a request to the acquirer bank to authorize the transaction. The acquirer bank in turn forwards the request to the Payment Network Operator (PNO) to seek confirmation of the card's validity. Finally, the PNO requests the issuing bank to authorize the payment using the card number, transaction amount and card status. Once the issuing bank authorizes the transaction, a confirmation is provided to the acquirer bank (via the PNO) to process the transaction.

The PNO typically enters into separate agreements with the issuing bank and the acquirer bank. Under such agreements, the issuing bank agrees to pay the PNO with respect to the authorized transactions (and receives interchange fees from the PNO in return for its services as part of the network). Furthermore, the PNO agrees to make payment to the acquirer bank with respect to the authorized transactions (and in return receives interchange fees for its services).

The interchange fee is consideration for a supply of services by the issuing bank. Whilst Interchange fees receivable and payable are often communicated to banks on a net basis, the issuing bank must determine the gross value of its supplies made to apply output VAT to the appropriate amount.

Income received by an issuing bank from a non-resident PNO is a consideration for the service provided to the acquirer bank and the underlying merchant. If the income relates to merchants and their acquirer banks who are resident in the Kingdom of Bahrain, this is consideration for a domestic supply of services and is not eligible for zero-rating. The PNO's place of residence does not affect the VAT application.

Income received by an issuing bank from a non-resident PNO, which relates to a merchant and acquirer bank outside the Kingdom of Bahrain, is consideration for supplies made to a non-resident. The zero-rate may apply to this income, provided that the remaining conditions of Article (73) of the VAT Executive Regulations are met.

In arrangements where the interchange fees are charged and collected by a non-resident PNO, the acquirer bank remains the service recipient. This means that the zero-rating may only apply in circumstances where the acquirer bank is a non-resident.

Local and GCC switch service

Each bank receives a “Daily Settlement Advice Report/Tax Invoice” issued by the local service provider, which lists the total amounts to be paid and received by the bank for the services provided on that day. The advice report also lists the total interchange fees payable and receivable for those services, together with the associated VAT. Fees payable and receivable in respect of GCC switching are reported in a separate section of the report.

Banks should treat these reports as supporting documents for VAT compliance purposes and should adopt the following treatment:

1. From the local section of the report:
    a. Treat the total debit amount of fees and commission as a standard rated purchase, and the total credit amount of fees and commission as a standard rated supply.
    b. Treat the total debit VAT on the fees and commissions as input VAT and the total credit VAT on the fees and commissions as output VAT.

2. From the GCC section of the report:
    a. Treat the total debit amount of fees and commissions as a purchase subject to the reverse charge procedure.
    b. Treat the total credit amount of fees and commissions which qualify as an export of services as a zero-rated supply.

Output VAT is payable to the NBR and input VAT may be recovered by applying your usual input VAT recovery methodology.

The debit and credit amounts are not to be netted off against each other unless one amount is a reversal of the other, for example when interchange received by an issuer is reversed by a refund to the acquirer.

International switch service provided by Network Operators

The non-resident PNO provides a daily statement of transactions to each bank, together with a report of the transactions undertaken. These statements and reports provide details of transactions, together with a balance of account which is either due from, or payable to, the PNO as a paying agent. The statements and reports detail interchange payable and receivable, and also detail the fees and commissions due to the PNO.

Banks should treat these statements and reports as the supporting documents for VAT compliance purposes, provided the reports contain at least the following information:

1. Name and address of the bank to which the report is issued
2. A unique report identification number
3. The date of issue of the report and the date of supply
4. The period covered by the report (e.g. 1 January 2024 – 31 January 2024)
5. A brief description of the amounts shown on the report
6. Sufficient detail to identify the total amount payable on local supplies
7. Sufficient detail to identify the total amount receivable on local supplies
8. Sufficient detail to identify the total amount payable on foreign supplies
9. Sufficient detail to identify the total amount receivable on foreign supplies

Treatment of interchange:

Transaction	Treatment
Total fees and commission paid to network operator located outside Bahrain	Purchase subject to the international reverse charge mechanism
Total fees and commission paid to network operator located inside Bahrain	Standard rate purchase
Interchange paid to card issuers or acquirers located in Bahrain	Standard rate purchase
Interchange paid to card issuers or acquirers located outside of Bahrain	Purchase subject to the international reverse charge mechanism
Total credit amount of interchange, fees and commissions received in relation to card issuers or acquirers located outside of Bahrain which qualify as an export of service	Zero-rated sale
Total credit amount of interchange, fees and commissions received related to card issuers or acquirers located inside of Bahrain	Standard rate sale

Output VAT is payable to the NBR and input VAT may be recovered by applying the usual input VAT recovery methodology.

The debit and credit amounts above are not to be netted off against each other, unless one amount is a reversal of the other, for example where an interchange received by an issuer is reversed by a refund to the acquirer.

The above guidance related to interchange is applicable effective from the 1st of September 2024.

2.7.3. 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 10% when supplied in Bahrain.

2.7.4. 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 10% when supplied in Bahrain.

2.8. 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 and is subject to VAT at the standard rate of 10% when supplied in Bahrain.

2.9. Cryptocurrency transactions

2.9.1. Introduction

Crypto assets are virtual or digital assets or tokens operating on a blockchain platform, protected by cryptography. There are four types of tokens recognized in Bahrain. These are set out below together with their VAT treatment.

2.9.2. Payment tokens

Payment tokens (cryptocurrencies such as Bitcoin) are virtual currencies intended to be used as a means of payment for acquiring goods or services or as a means of money or value transfer. The VAT treatment for these tokens is as follows:

a. Tokens received by miners for their mining activities are outside the scope of VAT. This is because mining is not an economic activity as there is an insufficient link between the service provided and any consideration received. From a practical perspective, there are no customers capable of receiving the mining service;

b. The exchange of tokens for legal tender or other tokens, and vice versa, are supplies of financial services exempt from VAT;

c. The use of tokens to acquire goods or services does not result in a supply of the token, and is outside the scope of VAT as the token only represents a means of payment;

d. The supply of goods and services remunerated in payment tokens should be treated in the same way as those remunerated in traditional currencies, and should follow the treatment set out in the VAT Law and Regulations;

e. The VATable amount of a transaction is the consideration received by the supplier. If this is expressed in payment tokens, the VATable amount should be the equivalent amount in Bahraini Dinar at the time of the transaction;

f. Any charges over and above the value of the payment tokens made for arranging a transaction in payment tokens will be exempt from VAT, except where the consideration for the service is expressly determined as a fee, commission or commercial discount, in which case the supply will be subject to VAT;

The exchange rate used to convert supplies denominated in payment tokens into Bahraini Dinars for VAT compliance purposes will be the rate published on the CBB website. Where this is not available, a VATable supplier should use an exchange rate available on the open market, and the source of the rates should be used consistently by the VATable supplier for the translation of all transactions involving payment tokens.

2.9.3. Utility tokens

Utility tokens are tokens that are intended to provide access to a specific application or service, but are not accepted as a means of payment for other applications. These tokens are similar in nature to vouchers and should be treated in the same way for VAT purposes.

Where the tokens can be exchanged for goods or services which are subject to the same VAT rate, the token will be a single purpose voucher with its date of supply being its issue date. VAT will be due based on the consideration paid for the token at the date of supplying the token.

In all other cases (multi-purpose vouchers), VAT will be due on token at the date of supplying the goods or services which are exchanged for the token on the basis of the value of the consideration paid for the token, or the face value of the token where the value of the goods or services is not specified.

2.9.4. Asset tokens

Asset tokens represent assets, such as a debt or equity claim on the issuer. They promise a share in future company earnings or future capital flows, and are analogous to equities, bonds or derivatives. These tokens are exempt supplies of financial services, unless supplied for an additional explicit fee, commission or commercial discount above the market value of the token, in which case they will be supplies subject to VAT.

2.9.5. Hybrid tokens

Hybrid tokens are those that have features of one or more of the other three types of tokens. The VAT treatment of such tokens needs to be determined on a case-by-case basis, and, depending on the specific circumstances, may be a single composite supply or multiple supply of goods and/or services.

In all cases mentioned above, exempt supplies are capable of being zero rated under Article 73 of the VAT Executive Regulations.

3. Credit and financing services

3.1. Introduction

This section will provide guidance on the VAT treatment applicable to credit and financing services when supplied in Bahrain by a VATable person. For further information on the rules to determine the place of supply and the VAT 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. The correct VAT treatment of services provided should, at all times, be assessed and determined based on the specific terms and conditions of the relevant contracts, as these may differ from the generic services covered in this Guide.

3.2. Granting of loans, lines of credit, overdrafts

3.2.1. 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.

3.2.2. VAT Treatment

The supply of interest-bearing finance and credit services is a financial service. Such services, when provided by VATable 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 VAT due date rules.

Services associated with the grant of financing

When supplied in Bahrain, they are subject to VAT at the standard rate of 10%, 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 the VAT 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.

VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide for further detail). VATable persons are required to issue VAT invoices for VATable fees or commissions charged in consideration for their services associated with the grant of financing.

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

Input VAT 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 13.6 of this Guide for further detail).

Example

A bank (VATable 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 charges an arrangement fee to the borrower for the preparation of the financing file.

The bank will be required to charge VAT at the standard rate of 10% on its arrangement fee and to issue a valid VAT invoice. This service should be considered as a one-off supply of services for the application of the VAT due date rules.

The interest income charged by the bank will be VAT exempt and the bank will not be required to issue valid VAT invoices. It should ensure 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 VAT due date rules. Regarding the computation of the bank's input VAT recovery ratio under the standard method of apportionment, the bank will have to include the following:

- *The value of the arrangement fee (subject to VAT)*
- *The value of the interest income (exempt)*

3.3. Secured loans

3.3.1. 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 3.2 of this Guide for further detail).

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

3.3.2. 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 a secured loan is a mortgage, 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 real estate located in Bahrain. A bank, which is VATable 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 VATable 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 the same even where the borrower is a VATable person and the collateral given to the bank is 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 VATable supply of goods or services by the borrower (where the borrower is a VATable 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 VAT and is not entitled to recover it in his VAT return.

Example

The borrower, in the 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 proceeds to repay the borrower's outstanding debt as well as sales related costs. Any surplus left will be transferred 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 VATable person.

If the sale was conducted by the bank on behalf of a VATable person, that sale would fall within the scope of VAT (e.g. a borrower VATable person who is forced by the bank to sell an asset).

In order to facilitate the sale of the property, the bank incurred certain costs on behalf of the borrower (e.g. legal costs associated with the sale agreement, property diagnostic costs, etc) that it will recover from the sales 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 VAT return and must instead recover it from the borrower.

3.4. Syndicated loans

3.4.1. 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.

3.4.2. 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 it is entitled as lender (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 lead bank 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 3.2 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 10% 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 VAT 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 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 VAT invoices to each syndicate member for their respective portion of the service fee.

Example

A Bahrain resident VATable, needs financing for a new infrastructure development project. The financing is granted by a syndicate of three Bahraini banks, contributing respectively 40% (Bank A), 30% (Bank B) and 30% (Bank C) of the financed amount. The borrower enters into a syndicated loan agreement with the three 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 and interest).

The three banks have agreed that Bank A will 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 disregards the portion of the payment which corresponds to the repaid principal amount (outside the scope of VAT) and treats 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 10% on the fee it has deducted from the allocation made to Bank B. Bank A must issue a valid VAT 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.*

3.5. Servicing of loans

3.5.1. 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.

3.5.2. 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 10% 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 the VAT 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.

3.6. Services of intermediaries

3.6.1. 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).

3.6.2. 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 10% 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 the VAT 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).

4. Asset financing

4.1. Introduction

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.

4.2. Self-finance and third party finance arrangements

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.

Under a self-financed arrangement, the dealer itself offers a financing arrangement to the purchaser of the goods, the following supplies occur for VAT purposes:

a. A supply of goods (the asset), for the sales price of the asset; and

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

Under a third party finance arrangement, a bank or finance company is interposed between the dealer and the purchaser, 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 goods (the asset) by the dealer to the bank or finance company for the sales price of the asset;

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; and

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

4.3. VAT treatment

4.3.1. Supply of the asset

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 10%, unless they fall within 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. The fact that the consideration for the goods will be paid by instalment does not make 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 VAT invoice is issued or a (partial) payment is received prior to that date). The dealer is required to issue a VAT 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 VAT invoice is issued or a (partial) payment is received prior to that date).[2] The bank or finance company is required to issue a VAT 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 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.

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, by instalments, 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.

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

- It will be able to recover in full the VAT charged by the dealer on his VATable supply of the asset (because the bank or finance company will use the asset for the purpose of making an onward VATable 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 13.6.1 of this Guide). This sale must be excluded from the computation as its inclusion may be distort the bank or finance company's recovery position. This is because the sale of a capital asset, 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.

4.3.2. 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 analyzed above under the loans, credit and overdrafts category at section 3.

Example

Malek, a VATable person resident in Bahrain, applies for financing for a tractor from a specialized finance company which is a VATable 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 x 6.5%): BHD 12.187*

1. *Supply of the tractor from the dealer to the finance company*
    - *The dealer is registered for VAT in Bahrain and charges 10% VAT on the selling price of the tractor (i.e. BHD 900; 10% 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 VAT invoice or the tractor being put at the disposal of the farmer.*
    - *The dealer must issue a VAT invoice to the finance company and the finance company will be able to reclaim this VAT in its VAT return.*

Example (continued)

2. *Supply of the tractor from the finance company to Malek*
   - *The finance company charges 10% VAT on the selling price of the tractor (i.e. BHD 900 - 10% 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 VAT invoice or a payment is received beforehand).*
   - *The finance company must issue a VAT invoice to Malek who may be able to reclaim this VAT in its VAT return (subject to general input VAT recovery rules).*
   - *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.*
3. *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 VAT 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 VAT due date rules.*
4. *Finance company's input VAT 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 VAT invoice issued by the dealer).*
   - *The value of the sale of the tractor to Malek must not be included for the computation of its input VAT recovery apportionment ratio under the standard method.*
   - *The value of the margin / interest income must be included for the computation of its input VAT recovery apportionment ratio under the standard method.*

4.3.3. 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 10% 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.

4.3.4. 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 10% 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.

4.3.5. 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 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 VAT credit note to the purchaser (see section 12.11.3 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 lower amount than that 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 these goods 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 a 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).

4.4. Operating leases

4.4.1. Overview

An operating lease is a contract that allows for the use of an asset but does not confer rights of ownership of the asset (either automatically or 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 analyzed 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.

4.4.2. 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 10% 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 lease rentals, as agreed in the contract;
- The date a payment is received;
- The issue of a VAT invoice.

5. Debts and debt related services

5.1. Introduction

This section will provide guidance on the VAT treatment applicable to debts. Please consult section 6 of this Guide for further detail on transactions related to debt securities, as these are not covered in this section.

For further information on the rules to determine the place of supply and the VAT 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. The correct VAT treatment of services provided should, at all times, be assessed and determined based on the specific terms and conditions of the relevant contracts, as these may differ from the generic services covered in this Guide.

5.2. Sale vs assignment of debts

5.2.1. Introduction

From a VAT perspective, it is important to distinguish between the assignment of a debt and the sale of a debt as the 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 meets the conditions to be 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.

5.2.2. 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, legal and beneficial interest 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.

5.2.3. 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. Factoring (with recourse)

5.3.1. 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. This means that 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.

5.3.2. 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 10% 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 VAT 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 VAT due date rules, the provision of a line of credit would generally be regarded as a continuous supply of services.

Please see section 3 of this Guide for further detail on the VAT treatment of financing services.

5.4. Factoring (without recourse) and forfaiting

5.4.1. 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).

5.4.2. 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 meets the conditions to be 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 VAT 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.

5.4.3. Input VAT 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's / business' input VAT recovery apportionment ratio (see section 13.6 of this Guide for further details).

If the owner has incurred VATable 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 meets the conditions to be an export of services subject to VAT at the zero-rate).

5.5. Securitization

5.5.1. 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.

5.5.2. 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 sell and acquire the debt, subject 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 meets the conditions to be 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 13.6 of this Guide).

If the originator has incurred VAT on 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 is of an 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 10% 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 VAT due date rules.

5.6. Debt collection

5.6.1. Overview of products / services

Debt collection services consist of attempting to collect payments from a debtor on behalf of a creditor 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 center support, etc.

5.6.2. 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 10% 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 VAT due date rules.

6. Capital and money markets

6.1. Introduction to equity and debt securities

6.1.1. 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); and
- Subscription privileges in the event of a new issue of shares (pre-emptive rights).

6.1.2. 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.

6.2. Issue of equity and debt securities

6.2.1. 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.

6.2.2. 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 VATable person, may be able to (partially) recover the VAT incurred on these costs, in accordance with the general principles for input VAT recovery (see section 13 of this Guide for further detail on input VAT recovery). This position applies to equity and debt securities issued on a primary market either publicly (IPO) or through private placement.

The holders of the securities may receive payments that arise due to their holding. The VAT treatment is summarized as follows:

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. VATable person or not)
Repayment of principal	Repayment of principal by the security issuer to the security holder	Outside the scope of VAT

6.3. Underwriting services

6.3.1. 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).

6.3.2. 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 10%, 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 VAT due date rules.

6.4. Sale of equity and debt securities

6.4.1. Overview of products / services

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

6.4.2. 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 VAT due date rules.

6.4.3. VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide for further details).

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

6.4.4. Input VAT recovery

When computing the seller's input VAT recovery apportionment ratio under the standard method, the margin realized on the sale of the securities should be taken into account (see section 13.6 of this Guide for further detail).

6.5. Securities lending

6.5.1. 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.

6.5.2. 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 VAT due date rules.

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

6.5.3. VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide for further details).

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

6.5.4. Input VAT recovery

When computing the lender's input VAT 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 13.6 of this Guide for further detail).

6.6. Other services associated with equity and debt securities

6.6.1. 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.

6.6.2. 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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

A summary of the VAT treatment of securities related services is as follows:

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	VATable VAT exempt (or zero-rated)	Underwriting fees and commission are VATable Margin realized by underwriter (if any) is VAT exempt
Exchange listing services	VATable	Services remunerated by a fee
Brokerage services	VATable VAT exempt (or zero-rated)	Brokerage fee or commission is VATable Margin realized (when broker acts as principal / counterpart) is VAT exempt
Other services (registrar, SWIFT, clearing and settlement, date and research, professional services, etc)	VATable	These services are generally remunerated by way of fee or commission

7. Financial derivatives

7.1. Supply of financial derivative contracts

7.1.1. 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 a financial service 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 an underlying financial asset 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, where the net cash position triggers 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).

7.1.2. 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 VAT due date rules.

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

7.1.3. VAT invoice requirement

The issue of a VAT invoice is mandatory for supplies of services performed in Bahrain (see section 12 of this Guide for further details).

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

7.1.4. Input VAT 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 13.6 of this Guide for further detail).

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

7.2.1. 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.

7.2.2. 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 10%, unless the conditions to apply the zero-rate of VAT (for export of services) are met.

An overview of the VAT treatment of these services is as follows:

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

8. Asset management

8.1. Introduction

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).

8.2. Discretionary asset management (segregated and pooled)

8.2.1. 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 an investment or 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.

8.2.2. 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 10%, 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 VAT 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. Please see Appendix F of this Guide for further detail.

8.3. Investment advisory services

8.3.1. Overview of products / services

Investment advisory services consist of providing advice to customers on their financial position and how they may wish to invest their funds. Unlike 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 in relation to 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.

8.3.2. 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 10%, 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 VAT 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).

8.4. Execution services

8.4.1. 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.

8.4.2. 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 10%, 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 VAT due date rules.

8.5. Collective Investment Schemes

8.5.1. 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 the 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 regarded to be 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 regarded to be 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).

8.5.2. VAT treatment

Given the type of financial activities in which investment funds are engaged, it is expected that they mainly carry out VAT exempt activities, or, when trading outside the Implementing States, partially zero-rated activities. They are therefore expected not to be entitled to recover input VAT 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 VAT return, and

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

9. Islamic Finance products

9.1. Introduction

This section provides guidance on the VAT treatment applicable to Islamic finance products when supplied in Bahrain by a VATable person. For further information on the rules to determine the place of supply and the VAT 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. The correct VAT treatment of services provided should, at all times, be assessed and determined based on the specific terms and conditions of the relevant contracts, as these may differ from the generic services covered in this Guide.

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 underlying goods. 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 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 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.

9.2. Murabaha

9.2.1. Overview of products / services

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

9.2.2. VAT treatment

The remuneration for the financing service is the profit margin earned on the difference between the acquisition price of the goods 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 4.2 of this Guide for further details.

9.3. Ijara (followed by sale)

9.3.1. 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.

9.3.2. 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 goods 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 4.2 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 4.2 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 10% or at the zero -rate (export of services).

Example

Rania, a private individual resident in Bahrain, asks for financing from her bank for a new car. The bank provides this 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 11,000 (VAT included). The monthly installment to be paid by Rania is broken down as follows:

- *Car value (BHD11,000 / 60 months): BHD 183.33*
- *Margin: BHD 7.875*

The following happens from a VAT perspective:

1. *Supply of the car from the dealer to the bank*
    - *The dealer is registered for VAT in Bahrain and charges 10% VAT on the selling price of the car (i.e. BHD 1,000; 10% 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 a VAT invoice or the car being put at the disposal of Rania.*
    - *The dealer must issue a VAT invoice to the bank and the bank will be able the claim this VAT back in its VAT return.*
2. *Supply of the car from the bank to Rania*
    - *The bank charges 10% VAT on the selling price of the car (i.e. BHD 1,000; 10% 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 VAT invoice or payment is received beforehand).*
    - *The bank must issue a VAT invoice to Rania. However, Rania will not be able to claim this VAT, as she is not a VATable 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.*
3. *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. BHD 7.875). 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 VAT 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.*

Example (continued)

- *The financing services should be considered as a continuous supply of services for the purposes of the VAT due date rules.*

4. *The bank's input VAT 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 VAT invoice issued by the dealer).*
   - *The value of its VATable sale to Rania must not be included for the computation of its input VAT recovery apportionment ratio under the standard method.*
   - *The value of the margin income must be included for the computation of its input VAT recovery apportionment ratio under the standard method.*

9.4. 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 4.4 of this Guide.

9.5. Commodity Murabaha / Tawarruq

9.5.1. 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.

9.5.2. 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 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 consideration for VATable supplies of services when supplied in Bahrain. They are therefore subject to VAT at the standard rate of 10% 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 enters into a commodity Murabaha / Tawarruq agreement with his bank. Under this agreement:

- *The bank purchases metal for BHD 2,500 and on-sells it to Ali for a marked-up amount of BH 2,700, with deferred payment over twelve months. There is no physical delivery of the metal.*
- *The bank arranges for Ali to on-sell the metal 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.

9.6. Musharaka

9.6.1. 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. real estate).

9.6.2. 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 3 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 instalments comprising both the right to use the specific asset and the purchase of the Islamic Finance institution's share in that given asset. Please see section 9.3 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).

9.7. Mudaraba

9.7.1. Introduction

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

9.7.2. 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.

9.7.3. 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 remuneration for a financial service to the customer and is subject to VAT at the standard rate of 10% 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.

9.7.4. 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 10% 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).

9.8. Wakala

9.8.1. Introduction

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.

9.8.2. 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 associated 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 carrying out 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 10% when supplied in Bahrain unless they meet the criteria to be an export of services and are subject to VAT at the zero-rate.

9.8.3. 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 remuneration for a financial service and is subject to VAT at the standard rate of 10% 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.

9.9. 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 2.6 of this Guide for further details on the VAT treatment applicable to Kafalah.

9.10. Islamic bank cards

Overview of products / services

In a similar way to conventional credit cards, Islamic bank cards can 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 2.4 of this Guide, as the VAT treatment covered in this section applies in the same manner to Islamic Finance institutions.

9.11. Sukuk

9.11.1. 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 6.2 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 analyzed in order to apply the correct VAT treatment applicable to it.

9.11.2. 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 VATable 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 as an export of services.

Please see section 6.4 of the Guide for further details on the VAT treatment of the sale of debt securities.

10. Insurance

10.1. Introduction

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 VAT treatment of Islamic contracts with the conventional insurance contracts that they are economically equivalent to.

As a general comment, which is applicable to all types 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 VAT due date rules (see Appendix B of this Guide).

10.2. 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 regarded as financial services for VAT purposes.

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 analyzed 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.

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

Additional fees may be charged to 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 10% 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 regarded as a financial service and the VAT treatment will be the same as the provision of the contract itself (i.e. VAT exempt).

10.3. 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 10% 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.

10.4. 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 VATable at the standard rate of 10% 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 10% 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.

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

3 Including: motor, property, accident and liability, aviation, marine (cargo, hull), energy, engineering, transportation, travel, medical, others

10.5. 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 10% 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 10% in Bahrain, unless they meet the conditions to be regarded as an export of services and are subject to VAT at the zero-rate.

10.6. Payment of claims

10.6.1. Settlement and indemnity payments

Any settlement made by the insurer in respect of an insurance 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"), 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 and a VATable person.

60% of Zee's building is damaged by a fire. 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.

10.6.2. Third party costs

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 VAT 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 VAT 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 VAT 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 VATable 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 VAT 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 VATable person that can recover input VAT and is in possession of a VAT 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's equipment broke down, 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 a 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 8,800 (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 after a 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 VAT invoice to Anisa for the total cost of the repair as Anisa is the recipient of the repair services (i.e. BHD 525). Anisa cannot recover the VAT charged on this VAT invoice as she is not a VATable person.

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

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 VAT on the cost price of the goods when the goods are handed over to the insured.

10.6.3. 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.

10.7. Insurance intermediaries

10.7.1. Introduction

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

10.7.2. Insurance brokers

A broker usually acts by appointment of a person seeking insurance cover. He will assist his customer in finding cover 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 subject to VAT at the standard rate of 10%, unless they meet the conditions for the application of VAT at the zero-rate as an 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 VAT due date rules, depending on the exact terms and conditions of the brokerage contract. Some contracts may be 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 subject to VAT), he is solely acting as a collecting agent and these payment flows should be disregarded.

10.7.3. 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 subject to VAT at the standard rate of 10% unless they meet the conditions to be subject to the zero-rate as an 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 VAT 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 VAT invoices, subject to some conditions (see section 12.7 of this Guide). Under a self-billing arrangement, providing all the conditions are met, the insurance company will self-issue the VAT invoices (i.e. in lieu of its agent) for the commissions it owes to its agent.

11. 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 10%, 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 VATable person resident in Bahrain. It has outsourced the IT helpdesk for all its offices in Bahrain to Star Offices Ltd, a VATable person in Bahrain.

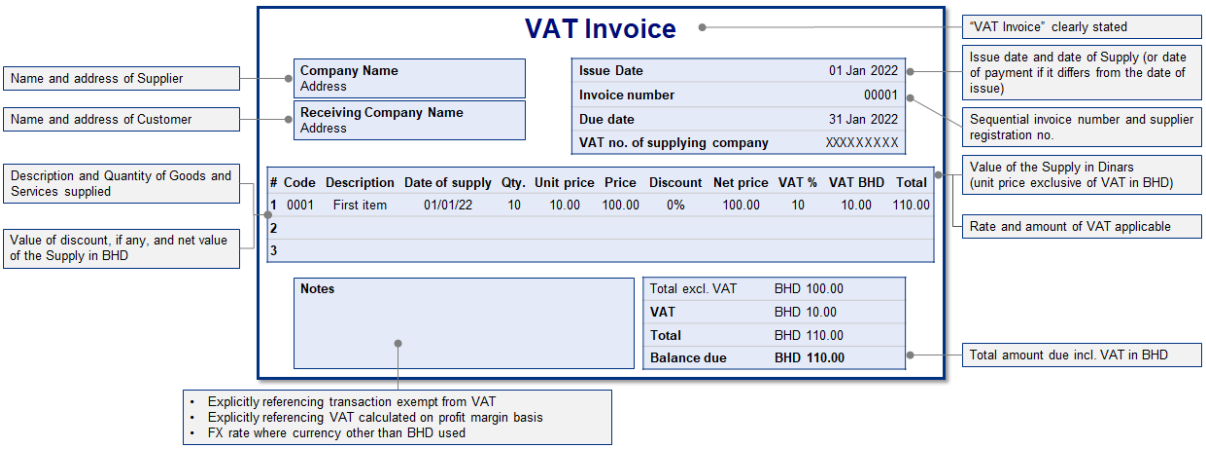
Star Offices Ltd charges Bank BH BHD 5,000 per month corresponding to the total salaries paid to the employees assigned to provide the IT helpdesk services plus a mark-up.

Star Offices Ltd provides VATable services to Bank BH and must charge VAT at the standard rate on the total amount received from Bank BH, i.e. 10% on BHD 5,000.

12. VAT invoices

12.1. Introduction

A VATable person making supplies of goods or services in Bahrain is required to issue VAT invoices and, depending on the circumstances, other documents. The purpose of this section is to highlight the obligation of a VATable person to issue this documentation together with the requirements that these documents must meet.



12.2. Principles

A VATable person must issue VAT 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 VAT invoice must be issued by a VATable person when making a deemed supply of goods and services. A VAT invoice must be delivered to the customer.

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

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

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

The issue of VAT invoices is required for the supply of zero-rated and exempt life insurance services.

12.3. Simplified VAT invoice

Generally, a VAT invoice needs to contain detailed information relating to the supplier, the customer and the supply, as described below. However, a VATable person may issue a simplified VAT 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).

12.4. Requirements for a VAT invoice and simplified VAT invoice

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

Description	Full VAT invoice	Simplified VAT invoice
The label “VAT Invoice”	✓	✗
The name of the supplier	✓	✓
The address of the supplier	✓	✓
VAT Account Number of the supplier	✓	✓
The name of the customer	✓	✗
The address of the customer	✓	✗
A sequential VAT invoice number	✓	✗
The date of issue of the VAT invoice	✓	✓
The date of the supply or the date of payment, if different from the date of issue of the VAT invoice	✓	✗
A description of the supply provided	✓	✓
Quantity of the goods provided	✓	✗
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)	✓	✗

Description	Full VAT invoice	Simplified VAT invoice
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	✓	✖
A clear statement where a transaction is exempt from VAT	✓	✖
Where the profit margin scheme is used, a reference that VAT has been charged based on the profit margin scheme	✓	✓

12.5. Bank statements

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

- The name, address and VAT account number 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 VAT invoices have to be issued within the normal deadline for VAT invoices, i.e. by the 15th day of the month following the month during which a VAT due date was triggered.

12.6. Summarized VAT invoice

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

12.7. Self-issued VAT invoice

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

- There is an agreement in writing between both parties allowing the issue of VAT invoices by the customer

- The supplier undertakes not to issue any VAT invoice when a transaction is subject to self-invoicing
- There is a mechanism whereby the supplier is able to approve every VAT invoice issued by the customer on his behalf
- The VAT invoice clearly states that it is issued by the customer on behalf of the supplier
- The customer retains a copy of every VAT 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 VAT invoice

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

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

A VATable 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.

12.9. Invoices issued in foreign currency

Where a VAT invoice is issued in a foreign currency, the VATable person must convert the amounts stated on the VAT invoice to Bahraini Dinars. The exchange rate approved by the Central Bank of Bahrain as at the VAT 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. VATable persons should use the same source consistently until the exchange rates approved by the Central Bank of Bahrain are available.

12.10. Rounding rules

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

12.11. Adjusting a VAT invoice

12.11.1. Overview

A VAT 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 VAT invoice is overstated or understated and needs to be amended, the VATable person must make an adjustment by issuing a credit note or debit note depending on the circumstances.

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

12.11.2. Issue of a debit note

Where a change in a VATable supply leads to an increase in output VAT, 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 made.

12.11.3. Issue of a credit note

Where a change in a VATable supply leads to a reduction of output VAT, a VAT 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 VAT under the bad debt relief provisions.

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

12.11.4. Requirements for debit and credit notes

VAT debit and credit notes should contain the following:

- The label “Credit Note” or “Debit Note”, clearly displayed on the document
- The name, address and VAT account number 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
- The sequential number of the original VAT invoice being adjusted
- The adjusted value of the supply and the adjusted amount of VAT in Bahraini Dinars

12.12. Intra-VAT Group transactions

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

13. Input VAT recovery

13.1. Introduction

The purpose of this section is to outline the conditions to be met in order to be able to recover input VAT incurred on purchases and expenses. This section also covers the various input VAT recovery adjustment requirements, including adjustments under the capital assets scheme.

13.2. General principles

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 VATable supplies (i.e. supplies subject to VAT at 10% or 0%)

The recovery of input VAT is subject to conditions that must be met before it may be recovered on a VAT return.

13.3. Conditions

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

- The person making the claim must be a VATable person;
- The expenses on which VAT is charged must have been incurred for the purpose of that person's economic activity;
- The recovery of input VAT on the expenses is not specifically disallowed by the VAT Law;
- These expenses are used for making VATable supplies (i.e. supplies which are not exempt from VAT);
- The person making the claim has the supporting original VAT invoices which comply with the requirements of the Law or, for imports of goods, the relevant import documentation;
- Input VAT is claimed within the time limit set by the VAT Law, i.e. five years.

13.4. Timing for input VAT recovery

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

As a result, the recovery position for input VAT on a given expense is the recovery position existing in the VAT 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 input VAT can only formally be claimed in a VAT return for a later VAT period. This may happen where a VAT payer was not in possession of a valid VAT invoice on time to claim it in the VAT return for the VAT period where VAT became chargeable on the supply.

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

Example

A bank incurs VAT on a business purchase during a VAT period where its input VAT 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 VAT invoice for this purchase until one year later, when its input VAT recovery ratio is 85% (i.e. at the time it receives the invoice, the bank can recover 85% of the input VAT on its expenses). The bank can only ask for the recovery of the input VAT on this purchase at the time it receives the compliant VAT invoice but it should use the 67% recovery rate (which corresponds to the recovery ratio at the time that input VAT became recoverable).

13.5. Methodology to compute the recovery of input VAT

13.5.1. Introduction

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

13.5.2. 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 VAT and can be included in the input VAT recovery computation. As a result, if a VAT payer incurs expenses used only for the purpose of his non-economic activity (e.g. he holds shares as a passive investment and he incurs 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 a VAT payer incurs expenses which relate to both his economic and non-economic activities, he must 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 his economic activity will be regarded as input VAT and can be included in his recovery computation.

13.5.3. Input VAT disallowed by law

Once the VAT payer has identified the expenses used for his economic activity, he needs to identify, whether the input VAT on these expenses is disallowed under the VAT Law and the Executive Regulations.

Input VAT 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 VAT 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 VAT on these expenses may lead to final consumption free of VAT.

Expenses for which input VAT recovery is blocked	Examples
Input VAT 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 VAT 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 VAT paid on goods and services to be used by employees for free for personal use, except when these are required by labor 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 VAT paid on mobile phones and vehicles provided to employees and on related services such as maintenance, repair and insurance to the extent of non-business use of the phones, vehicles and related expenses. See the Frequently Asked Questions section of the NBR's website for information on how to compute the business versus non-business use for these expenses. There is no input VAT restriction on vehicles and related expenses when the vehicles are for civil defense purposes (i.e. ambulance, fire, police vehicles) or are the VATable 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 • Purchase of mobile phones used by employees and related contracts for the supply of telecommunications services The VATable person must identify the non-business use portion on all these expenses and is not permitted to recover the VAT related to this portion.

Even if input VAT on these expenses could be recovered, the VAT payer would be required to recognize a deemed supply for each of these expenses, resulting in an obligation to pay to the NBR 10% VAT on the value of these supplies.

13.5.4. Direct attribution of expenses to VATable and exempt supplies

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

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

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

- VATable supplies in Bahrain at the VAT rate of 10% or 0%;
- Intra-GCC supplies; and
- Out-of-territorial scope supplies which would be VATable supplies if made in Bahrain (e.g. VAT payer held a conference in Spain for which he charged an entry fee).

For the purpose of the direct attribution "exempt supplies" include the following:

- Exempt supplies in Bahrain; and
- Out-of-territorial scope supplies which would be exempt supplies if made in Bahrain (e.g. VAT payer receives rent on a residential property in London).

Based on the above, where the VAT payer's economic activity is fully VATable, he should be in a position to recover in full the input VAT charged on his expenses. If his economic activity is fully exempt, he will not be in a position to recover input VAT charged on his expenses.

13.6. Apportionment of input VAT on residual expenses

Some VATable persons have an economic activity which is partly VATable 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 VATable supplies or their exempt supplies. Such expenses are usually called residual expenses. To determine the amount of input VAT 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.

13.6.1. Standard apportionment method

In order to determine the amount of input VAT on residual expenses that can be recovered during a VAT period, the VAT payer should apply an apportionment formula which provides the percentage of input VAT on residual expenses he can claim. The formula is an allocation between the VATable supplies (sales) and the exempt supplies (sales) of the VATable person for that VAT period and is as follows:

P = **A** ÷ (**A**+**B**) where **P** is the percentage of input VAT on residual expenses you can claim. **P** should be rounded up to the nearest decimal number.

A. The total value of supplies, made during the VAT period, that allow input VAT recovery including:
    - VATable supplies in Bahrain at the VAT rate of 10% or 0%;
    - Intra-GCC supplies; and
    - Out-of-territorial scope supplies which would be VATable supplies if made in Bahrain.
B. The total value of supplies, made during the VAT period that do not allow input VAT 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 VAT 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 VATable person
- The value of supplies which are incidental and do not constitute the core activity of the VATable 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 VATable person.

> ***Example***
>
> *A VATable person, whose activity is selling furniture, grants a bridging loan to a group company that needs cash at short notice. It earns interest on this loan. The interest is exempt from VAT, but should not be included in the value of supplies in computing the input VAT recovery percentage as it is an incidental supply.*

- The value of supplies made by an establishment of the VATable 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 VATable supplies and VAT exempt supplies. Transactions outside the scope of VAT include 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 should 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. The value of supplies on such margin transactions should be the “absolute value” of such transactions. Where the transaction results in a profit, the absolute value is the amount of the profit. Where the transaction results in a loss, the absolute value is the loss converted into a positive amount (i.e. drop the negative sign).

Example

Bank A has the following margin transactions:

Transaction No	*Accounting Value*	*Absolute Value for VAT purposes*
1	*BHD 250 (profit)*	*BHD 250*
2	*(BHD 175) (loss)*	*BHD 175*
3	*BHD 300 (profit)*	*BHD 300*
Total	*BHD 375 (net profit)*	*BHD 725*

13.6.2. Special apportionment methods

Alternative apportionment methods may be accepted by the NBR if the VATable 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 VATable 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 VATable activities compared to the number of staff working on exempt activities) and the number of transactions (number of VATable and exempt supplies, rather than their values).

A VATable person wishing to use a special apportionment method should make an application to the NBR. Until the NBR provides its approval, the VATable 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 VATable person must continue to apply the standard apportionment method.

The NBR may also direct a VATable person to use a special apportionment method where the standard method does not provide a fair and reasonable reflection of the VATable person's economic activity.

13.6.3. Annual adjustment of the apportionment ratio

The apportionment ratio has to be computed by VAT period, using the actual values of supplies during that VAT period. At the end of its VAT year, the VATable person must conduct an annual adjustment of the input VAT recovered throughout the VAT year. This is needed to ensure that input VAT has been recovered in a consistent way during the VAT year and to prevent abuses of the input VAT recovery rules.

At the end of its VAT year, the VATable person is therefore required to apply the apportionment formula as explained in sections 13.6.1 and 13.6.2 above using the total value of its supplies

to total residual expenses incurred during the VAT year. If a special apportionment method is used, that method should be applied to the VATable person's total residual expenses for the year.

If the amount of recoverable input VAT using the yearly formula differs from the sum of input VAT recovered in each VAT period of the VAT year, the VATable person must make an adjustment of the input VAT corresponding to that difference. This adjustment may result either in an additional amount of input VAT to be recovered, or in an amount of input VAT to be repaid to the NBR.

The annual adjustment should be reported either in the VAT return for the last VAT period of the VAT year or in the VAT return for the first VAT period of the subsequent VAT year.

For the purposes of applying the annual formula, the VAT year of a VATable person corresponds to the calendar year (i.e. 1 January to 31 December).

13.7. Adjustment to input VAT recovered

There are instances where input VAT recovered on expenses has to be adjusted. These are set out in the VAT Law and the Executive Regulations and are summarized below.

13.7.1. 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 VAT recoverable, the VATable person must adjust the amount of input VAT 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 VAT credit note and the adjustment can be done on this basis.

The adjustment of input VAT should be reflected in the VAT return for the VAT period during which the change in value occurred and the supporting documentation is received.

13.7.2. Failure to pay the consideration for the supply received

The entitlement to recover input VAT 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 twelve 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 VAT initially recovered by an amount corresponding to the unpaid amount of VAT.

The adjustment of the input VAT initially recovered should be reflected in the VAT return for the VAT period during which the bad debt relief is granted to the supplier.

If, at a later stage, the recipient VATable 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 VAT paid, in accordance with the input VAT recovery rules, in the VAT return for the VAT period during which the payment was finally made.

13.7.3. Change in use - Capital assets scheme

Input VAT on purchase of a capital asset

When purchasing a capital asset, a VATable person can recover the input VAT 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 VATable supplies only, the input VAT on this asset is fully recoverable;
- Where the capital asset is purchased for making of exempt supplies only, the input VAT on this asset is not recoverable; and
- Where the capital asset is purchased for making both VATable and exempt supplies, the input VAT on this asset is partially recoverable.

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 VATable supplies could, after some time, be used to make exempt supplies. The VATable person will have claimed 100% of the input VAT on buying the asset.

The capital assets scheme is designed to ensure that the correct amount of input VAT is recoverable by the VATable person based on the use of that asset over its lifetime, i.e. it is determined by whether it is used to make VATable 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 VATable person is required to adjust the input VAT has initially recovered.

Meaning of “capital asset”

A capital asset is a tangible or intangible asset that is assigned by the VATable person for long-term use as a business instrument (i.e. it is not stock for sale).

Period the capital assets scheme applies for

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 VAT year during which the capital asset was first used. Each subsequent year of the adjustment period starts following the end of the preceding VAT year. VAT year has the same meaning as for the annual adjustment of the apportionment ratio as discussed at section 13.6.3, i.e. the VAT year is the same as the Gregorian calendar year.

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 VAT 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 VAT return for the last VAT period of the adjustment VAT year or in the VAT return for the first VAT period of the subsequent VAT year.

Maintaining records relating to capital assets

VATable persons are required to keep and maintain a record of their capital assets and of the related input VAT recovery position throughout the adjustment period.

Input VAT on capital assets acquired before registration

Input VAT can be recovered on capital assets acquired before a VATable person's effective date of VAT registration provided the following conditions are met:

- The capital assets must have a positive net book value on the effective date of registration; and
- The capital assets must have been acquired or imported by the VATable person for the purposes of his economic activity and there must be a right to deduct input VAT, in accordance with the input VAT recovery rules.

The maximum input VAT 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 VATable person. The net book value is determined in accordance with the accounting practice of the VATable 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 VATable person.

A VATable 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 VAT paid);
- Copies of the VAT invoices issued by the suppliers; and
- Customs declarations for imports.

13.7.4. Cases where adjustment of input VAT is not required

An adjustment of the input VAT 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. See the “Lost, stolen or damaged goods” section of the VAT Retail and Wholesale Guide for further information on the evidence required by the NBR.
- 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)

14. Appendix

Appendix A. Place of supply

A.1. Introduction

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.2. 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.2.1. 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 movable 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.2.2. 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.3. 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.3.1. 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 VATable 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 (VATable person)

Where the customer is a VATable person residing in Bahrain and the supplier is non-resident, the place of supply of the services is the place of residence of the VATable 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 VATable persons in the financial services and the insurance sectors follow these two general rules.

A.3.2. Special rules

The VAT Law sets out special place of supply rules for services. These rules are summarized below.

Service	Place of supply
Rental of a means of transport to a customer who is not a VATable person	Where the means of transport is placed at the disposal of the non-VATable 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 VATable person in another Implementing State[4]	
Related to real estate	Where the real estate is located (see below)
Telecommunications and electronic services	Where the services are used and enjoyed, to the extent of such use and enjoyment

4 Rule not yet operable – will apply when Bahrain recognizes one or more GCC member states as Implementing States

Services related to real estate

Services related to 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

VATable persons in the financial services and the insurance sectors may carry out supplies of services following the special rule applicable to real estate related services.

A.4. 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 customs duty suspension regime[5] upon entering the territory of the Implementing States, the place of supply for the import of these goods is in the Implementing State to which the goods will be shipped (their final destination) when released from their temporary customs duty suspension regime.

5 For example: Customs warehouse, temporary admission and transit.

Appendix B. VAT due date

B.1. Introduction

The VAT due date refers to the time when VAT becomes chargeable on a VATable transaction. This is particularly important in order to determine the timeframe for charging VAT, issuing documentation such as VAT invoices, VAT credit notes and VAT debit notes, reporting in the relevant VAT return and payment of VAT to the NBR.

The VAT Law and Executive Regulations set out the general rules in order to define the VAT 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 VAT due date rule.

B.2. Supplies of goods and services

General VAT due date rules

The general VAT due date rules apply for all supplies of goods and services unless they fall under a special rule.

For supplies of goods, the VAT due date is the earliest of:

- The date of the supply of goods;
- The issue of a VAT invoice for that supply; and
- The receipt of a payment for that supply (to the extent of the amount received).

For supplies of services, the VAT due date for this supply is the earliest of:

- The date of the supply of the services;
- The issue of a VAT invoice for that supply; and
- The receipt of a payment for that supply (to the extent of the amount received).

Special VAT due date rules

In certain cases, supplies of goods and services follow special VAT due date rules. These are summarized below.

Supply	Special rule	Example
Continuous supply involving periodic payments or consecutive invoices (see below table for details)	VAT due date is the earliest of: • Date of issue of VAT invoice (to the extent of the amount invoiced) • Due date for payment as specified on the VAT 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 VAT 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 VAT due date will be triggered every 15th of each month to the extent of the amount actually paid, unless a VAT invoice is issued before that day.
Supply of goods deposited, and supply of goods pledged as collateral	VAT 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 2022, 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 VAT 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)	VAT due date is the earlier of: • The due date of each instalment under the contract; and • The date an instalment is paid.	A VATable 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 VAT due dates are respectively 1 October, 1 January, 1 April and 1 July, unless a payment is received beforehand where the VAT 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).	VAT 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 VAT 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 2022 with instalments to be collected every month until July 2023. The VAT due date for the supply of the drilling machine by the bank to its customer is on 1 February 2022, i.e. the day it is put at the disposal of the customer (for the purchase value of the machine).
Deemed supply	VAT due date is: • For goods or services provided for no consideration: where the goods are made available to the third party or where	Where a company offers awards and gifts to its employees (above the low value gifts threshold), the VAT due date will be the date on

Supply	Special rule	Example
	the services have been completed • For goods the VATable person retains upon deregistration: the effective date of deregistration • For transfer of the VATable 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.	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:

- Memberships
- 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 specific goods) 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 VAT 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 VAT 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.

The supply of goods supplied with payment by instalments (with or without an additional financing charge), is not a continuous supply. This supply is subject to the general VAT due date rules. If a financing element is attached to the sale (e.g. credit sale), this financing component will be a continuous supply of services.

B.3. Imports of goods

The VAT 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

C.1. Introduction

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 critical to identify, based notably on the terms of the existing agreements, whether a VATable person acts as one or the other.

C.2. 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 each other's identity 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, if a VATable person, is liable to apply the correct VAT treatment solely on remuneration earned for his intermediation services, usually in the form of a commission or success fee. He is also required to issue a VAT 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 policyholder) 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 10% 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 10% VAT on the brokerage fee he charges to the private individual.*

C.3. 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 by the undisclosed agent when reselling 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 VAT 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

D.1. Introduction

If a supply is made of more than one component (e.g. two services or a service and goods), the VAT payer will need to assess whether the supply is a single composite supply or multiple supplies.

D.2. 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, 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 VATable person in Bahrain provides international transport services (by plane) and, as part of the fare, also provides access to a business lounge and a supply of food and beverages. The lounge and catering services are provide 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 seek 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 one of the main components 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.3. 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 customers to buy 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 carried out 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 needs to be split in order to allocate to each supply the relevant portion of the consideration and to apply the relevant VAT treatment.

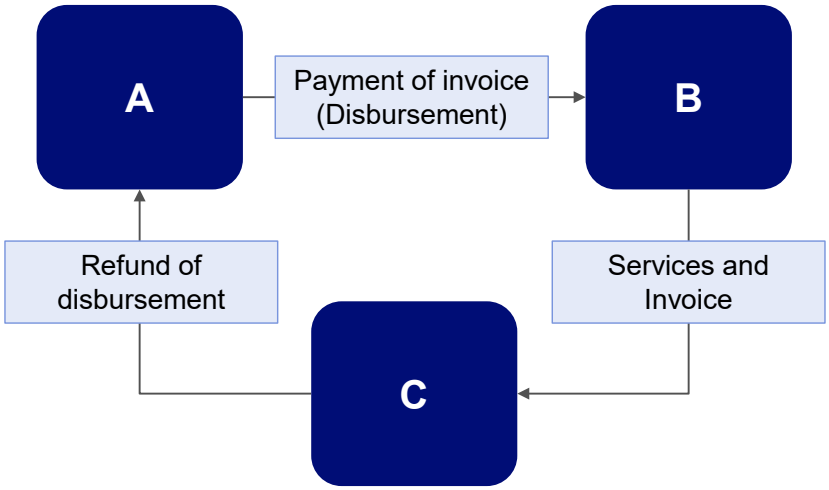
In the above example, the supply of transport will follow the VAT treatment applicable to the supply of international transport of passengers while the supply of insurance will follow the treatment applicable to insurance. The supplier will be required to separately identify the fee to be received for each supply.

Where the amount invoiced cannot be split and allocated to each separate supply, 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.

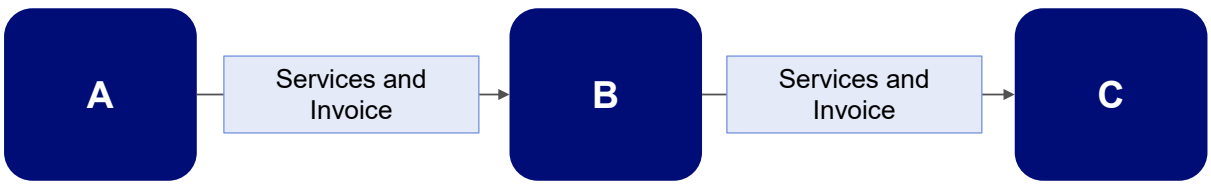


The payment and recovery by A are not supplies falling within the scope of VAT. A is only acting as a paying agent between B and C. The payment flows between A and B and A and C are mere disbursements and are ignored for VAT purposes.

E.2. Reimbursement

A reimbursement is different from a disbursement. For a reimbursement, a VATable person procures goods or a service for its customer and acts as a principal in the procurement chain. The VATable person will procure the goods 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 VATable person (B) acts in its own name, as a principal and is buying the goods or service from the third party (A) and on-selling it to its customer (C). Therefore, the VATable 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 VAT recovery rules.



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 VATable 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” a 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 or punitive charges. Such charges may be anticipated in the contractual terms between suppliers and their customers. From a VAT perspective, the name under which the charge is labelled and the fact such charge is anticipated in contractual terms shall not impact its VAT treatment.

As of 1 November 2024, all charges are considered VATable as they represent consideration for the broader scope of services provided unless the payment is in relation to an indemnification of an actual damage incurred. Such damages include instances where a person is awarded an amount for damages endured by a court, arbitration panel, or committee, or agrees to settle a dispute by accepting payment of damages.

All charges/fees imposed by banks, such as late payment fees or early termination fees are subject to VAT at the standard rate.

Examples of charges that are subject to VAT include but are not limited to:

- Where a supplier makes a supply available to a customer, but they do not avail themselves of all or part of that supply, and the supplier charges a payment to compensate them for having made the supply available that will normally be further consideration for that supply.
- Where a contract ends as a result of an action by the customer which causes the supplier to terminate a lease, then if the supplier charges a fee to cover the costs of making the supply, or an additional fee broadly equivalent to what would have been charged under the lease had it run as envisaged, then the payment is further consideration for the supply.
- Payments arising out of early contract termination will normally be further consideration for the contracted supply where the payments are linked to that supply.
- A charge for the late return of a hire car will normally be subject to VAT as it is made for the supply of the car, and the customer is aware that an additional charge will be made and how much that charge will be or how the charge will be calculated.

Examples of punitive charges in nature that are out of the scope of VAT include but are not limited to the following:

- Where a supplier takes legal proceedings against its customer due to a dispute that arose, the court may order the customer to compensate the supplier because of the damages caused.
- Where a supplier enters into a contract with a customer (business), a breach of clauses agreed upon within the contract requires an arbitration panel, such a panel mandates the customer to pay a remuneration.