



## Bahrain VAT Regulations – Synopsis for Financial Services Sector

The stage is set for implementation of Value Added Tax (VAT) in phased manner in the Kingdom of Bahrain (Bahrain) with the release of the Arabic version of the Executive Regulations (regulations) on 13<sup>th</sup> December 2018. As indicated in the VAT law released in October'18, financial services have been given the its due importance and most of the activities in this sector have been kept in the exempt category.

The impact of VAT on financial services sector has been analyzed by us based on unofficial translation of the Arabic version and the sector specific presentations released by the National Bureau of Taxation (NBT) and Ministry of Finance (MoF), Bahrain. Readers are advised to peruse the regulations and take counsel from WTS Dhruva or other tax advisors, before implementing any of the guidance / suggestions in their businesses.

### Bahrain VAT on Financial Services Sector

Rate	Taxability of Financial Services
<b>Exempt</b>	When consideration is not in the nature of specific fees, commission or commercial discount. This covers interest or margin-based products.
<b>Standard Rate 5%</b>	When consideration is in the form of fees, commission or commercial discount.
<b>Zero Rated</b>	When provided outside Bahrain irrespective of the form of consideration.



The executive regulations have provided an inclusive list of activities that would constitute financial services. The same is tabulated below for reference:

#### **Illustrative list of Financial services**

- Depositing money in savings, current or deposit accounts with banks
- Grant or transferring loans, advances and credit
- Issuing or cancelling of cheques, debit/credit cards
- Issuance/transfer/receipt of money, financial bonds, banknotes or money orders or transactions of similar nature
- Supply/issuance/arrangement of financial derivatives/deferred contracts
- Supply/issuance of shares/stock/bonds and securities related thereto
- ATM related transactions (other than installation/maintenance or operating software related thereto)
- Currency conversion whether through exchange of banknotes or related matters
- Supply/transfer of financial instruments, Sukuk, exchanges, options or any deferred financial contracts
- Issuance/assignment/renewal/amendment/rental /transfer of ownership of debentures/securities (whether listed or not), credit contracts or the like
- Providing/transfer of ownership of life insurance/re-insurance contract
- Providing insurance coverage/annual premiums under any investment scheme
- Providing/acquiring/ amending/cancelling a guarantee/compensation/insurance related to performance of obligations from partners/credits/securities/debentures or the like
- Any Islamic financial products provided under Sharia's-approved contracts, similar in terms of the intended objective to traditional financial products and achieving materially the same effects
- Commission on brokerage services or under Mudaraba contracts or agency contracts.

**Issuance/allocation/transfer of ownership or securities and debentures, concluding and transferring ownership of life insurance/re-insurance contracts will be considered financial services regardless of the form of consideration due thereon.**



Internationally, financial services sector is one of the most complex sectors when it comes to its treatment under VAT. The executive regulations and the presentation shared by NBT provide certain clarifications which are tabulated here below.

Issue	Clarification
<p><b>Penalties vs. fees</b></p>	<p>Penalties are outside the scope of VAT and fees are taxable.</p> <p>Important features required of penalty: -</p> <ul style="list-style-type: none"> <li>• Charges should be compensatory or punitive in nature</li> <li>• Paid to compensate or to sanction a breach of duties by one of the parties to a contract.</li> <li>• Party charged does not receive any specific supply in exchange for the payment</li> </ul> <p>A fee called penalty remains a fee if its true nature is that of a fee.</p>
<p><b>Pass-through costs – Disbursement vs. Recharge</b></p>	<ul style="list-style-type: none"> <li>• Recovery of fees paid by bank to third party, made in the name and on behalf of the customer is ‘<b>disbursement</b>’. No Supply involved and hence no Tax.</li> <li>• Recovery of fees paid by the bank to a third party, in its own name and then claimed from customer is a ‘<b>recharge</b>’ and is taxable. There are two supplies – 1<sup>st</sup> by the third party to the bank and 2<sup>nd</sup> supply from the bank to the customer.</li> </ul>
<p><b>Bank acting as insurance intermediaries</b></p>	<ul style="list-style-type: none"> <li>• Bank distributing insurance products (of another insurance company) to its customers, is providing intermediary/agency service between the bank and the insurance company. Same is taxable</li> <li>• Supply of insurance service is directly between the insurance company and the customer</li> </ul>
<p><b>Waiver of fees</b></p>	<ul style="list-style-type: none"> <li>• Waiver of fees should not give rise to a deemed supply to the extent the waiver is part of a “commercial” decision (e.g. to retain an existing customer or secure additional future income from a customer)</li> </ul>
<p><b>Asset Financing</b></p>	<ul style="list-style-type: none"> <li>• The value of the asset sold by the bank to the customer must be separately identified and VAT will have to be charged by the bank (unless the asset is exempt from VAT)</li> <li>• The value of the supply of credit (the financing for acquisition of the asset by the customer), i.e. the interest or profit margin earned by the bank, will be VAT exempt.</li> </ul> <p>On the other hand, Operating leases (conventional and Islamic finance) are considered as rental services for VAT and the rent will be subject to VAT in its entirety (unless the asset rented out is VAT exempt)</p>
<p><b>Bank Statement as Tax Invoice</b></p>	<p>Bank statement will be treated as Tax Invoice provided it contains following information:</p> <ul style="list-style-type: none"> <li>• Name, address and registration number of the Bank</li> <li>• Customer name and address</li> <li>• Date of issuance of bank account statement</li> <li>• Tax rate applicable to each supply</li> <li>• Amount of tax in respect of each supply</li> </ul>

**WTS Dhruva's Comments:**

- Executive regulations provide expansive list of activities that would qualify as Financial Services for the purpose of exemption.
- Zero rating of financial services provided to and used by Customers outside Bahrain is a very beneficial provision for the industry. It will help reclaim corresponding input VAT paid, if any, on procurements and reduce the cost.
- Bank statements with specific details are allowed to be treated as 'tax invoices. This will ease the bank operations. At the same time, it is suggested that there should not be any need to separately issue debit/credit notes and Bank statements can serve that purpose as well.
- NBT has acknowledged practical challenges for taxability of interchange fees being paid or received on a net basis. Guidance expected to be received separately.
- If, the fee / commission agreed in the contracts entered prior to the implementation date and are continuing thereafter, didn't mention about VAT being chargeable separately, such prices shall be considered to be inclusive of VAT at the time of actual supply made during the VAT regime.

Please read this alert in conjunction with our alert on Synopsis on the Bahrain VAT Executive regulations. WTS Dhruva will be happy to answer any query/ clarification or provide support in relation to Bahrain and GCC VAT. Please reach out to us at [gccvatquery@dhruvaadvisors.com](mailto:gccvatquery@dhruvaadvisors.com) or at +973 16631921.



## WTS Dhruva Consultants

### Bahrain

Bahrain Financial Harbour,  
East Tower, Office 2301,  
Building 1398, Road 4626, Block 346  
Manama, Kingdom of Bahrain  
Tel: +973 1663 1925

### UAE

U-Bora Tower 2,  
11th Floor, Office 1101  
Business Bay P.O. Box 127165  
Dubai, UAE  
Tel: + 971 56 900 5849

## Dhruva Advisors

### Mumbai

1101, One India Bulls Centre,  
11th Floor, Tower 2B,  
841, Senapati Bapat Marg, Elphinstone Road  
(West), Mumbai 400 013  
Tel: +91 22 6108 1000 / 1900

### Ahmedabad

B3, 3rd Floor, Safal Profitaire, Near Auda Garden,  
Prahladnagar, Corporate Road,  
Ahmedabad - 380 015  
Tel: +91-79-6134 3434

### Bengaluru

Prestige Terraces, 2nd Floor Union Street,  
Infantry Road, Bengaluru 560 001  
Tel: +91-80-4660 2500

### Delhi/NCR

101 & 102, 1st Floor,  
Tower 4B DLF Corporate Park  
M G Road, Gurgaon  
Haryana - 122 002  
Tel: +91-124-668 7000

### New York

Dhruva Advisors USA, Inc.  
340 Madison Avenue,  
19th Floor, New York,  
New York 10173 USA  
Tel: +1-212-220-9494

### Silicon Valley, USA

Dhruva Advisors USA, Inc.  
5201 Great America Parkway, Santa Clara,  
California 95054  
Tel: +1 408 930 5063

### Singapore

Dhruva Advisors (Singapore) Pte. Ltd.  
20 Collyer Quay, #11-05,  
Singapore – 049319  
Tel: +65 9105 3645

## Contacts

### Dinesh Kanabar

Chief Executive Officer  
dinesh.kanabar@dhruvaadvisors.com  
Phone: +91 22 6108 1010/11

### Pratik Shah

Resident Partner & VAT Expert  
pratik.shah@dhruvaadvisors.com  
Phone: +971 55957 8232

### Nimish Goel

Resident Partner & VAT Expert  
nimish.goel@dhruvaadvisors.com  
Phone: +971 50106 6531

### Nilesh Ashar

Resident Partner & VAT Expert  
nilesh.ashar@dhruvaadvisors.com  
Phone: +971 50106 6531

### Gaurav Khurana

Executive Director, KSA & Bahrain  
gaurav.khurana@dhruvaadvisors.com  
Phone: +973 3442 3043

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