



Tax Learnings

17 October 2021

Recent case of penalties imposed by the National Bureau for Revenue (NBR)

Finance vs operating lease

Background	<p>Certain businesses have been penalized by the NBR for incorrectly classifying finance lease arrangements as an operating lease.</p> <p>The incorrect classification has resulted in delayed payment of VAT to the NBR due to the different tax due date rule for finance lease and operating lease arrangements.</p>
Penalty exposure	<p>BHD 15,000/- upwards</p>
Our comment	<p>Under certain financing arrangements, the goods contractually remain the property of the lessor until expiry of the lease period and settlement of all dues by the lessee. Once the lease period expires and all dues have been settled, the asset may be transferred to the lessee by the lessor.</p> <p>In such cases, it is essential to examine the arrangement to determine whether the contract qualifies as an 'operating lease' or as a 'finance lease'. Factors to be considered while making this determination include whether the:</p> <ul style="list-style-type: none"> - ownership of the asset is transferred at the end of the lease term - lessee is able to purchase the asset at a price that is expected to be sufficiently lower than the fair value on the date the asset is transferred - lessee bears the losses associated with termination incurred by the lessor where the lease is terminated prematurely by the lessee - lease term is for the major part of the economic life of the asset even if the ownership is not transferred during that period <p>An operating lease arrangement is seen as supply of service by the lessor where a right to use the asset is extended to the lessee and the liability to pay the VAT arises on every periodic payment or due date as per the contract, whichever is earlier. Conversely, a finance lease arrangement is seen as a supply of goods by the lessor to the lessee and the liability to pay VAT arises when the vehicle is put at the disposal of the lessee on the entire purchase value, as opposed to on each periodic payment in case of an operating lease.</p> <p>Where a finance lease is misclassified as an operating lease, VAT on the entire value of the vehicle should have been reported in the VAT return for the month in which the vehicle was put at the disposal of the customer and no VAT should have been reported on the monthly lease payments. This leads to under reporting of sales for the tax period in which the asset is provided to the customer and excess reporting of sales for the tax periods in which the monthly lease payments become due/are received.</p>

Did you know?

VAT registration for holding companies

As a general rule, resident entities with annual revenue of more than BHD 37,500/- in a year are obligated to register for VAT. However, there may be cases where a holding company exclusively generating non-taxable dividend income may be required to register for VAT.

As per Article 33 of the Bahrain VAT Executive Regulations (ER), Bahrain resident entities are required to register for VAT in Bahrain, if the value of their “annual supplies” exceeds or is expected to exceed BHD 37,500/-. To compute the annual supplies for an entity, the following must be included:

1. Taxable supplies of goods and services, excluding the value of capital assets
2. Deemed supplies
3. Intra-GCC supplies which would have been taxable if made in Bahrain
4. Taxable supplies of goods and services made by related persons
5. Goods and services received by the resident entity for which the resident entity is liable to account for VAT under the reverse charge mechanism (RCM)

Based on the above, holding companies exclusively generating non-taxable dividend income may be required to register for VAT purposes in Bahrain if they are receiving goods and services worth BHD 37,500/- or more from non-resident suppliers where they are liable to account for VAT under RCM.

Accordingly, Bahrain resident entities should also consider the following factors for determining their VAT registration obligation:

- Are overhead expenses incurred being recovered from subsidiaries?
- Is there an agreement with subsidiaries under which a management fee is being charged on a periodic basis?
- Are there services being received from non-resident suppliers?

Once registered, it is also critical for the holding company to assess whether it can recover the input VAT on supplies received from local suppliers. This will primarily depend on whether such purchases are attributable to taxable or non-taxable supplies.

The above is for general information only and is not intended to address the circumstances of any particular scenario. Please seek professional advice in relation to your particular circumstances.

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