

VAT brief | NBR's VAT economic activity guidelines

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Bahrain's National Bureau for Revenue (NBR) released its VAT economic activity guidelines on 17 August 2020. In this brief, we highlight key clarifications and interesting points raised in the guide

Objective test

Carrying on 'an economic activity' is critical to determining whether an entity has to register for VAT. Whether an entity carries on an economic activity is an objective test requiring consideration of:

- The **intention** to generate income (whether or not the entity makes a loss or a profit) – the intention is important;
- **Frequency** of transactions – with reference to the type of business (a rare antiques dealer may sell four items over a year and still carry on an economic activity)
- **Quantity** of purchases – over and above personal use
- Use of **financing**
- Amount of **time** and **effort** put in by the business owner
- Degree of **advertising** and **promotion**
- Engagement in **business-related transactions**
- **Nature** of assets – whether they are for personal investment or business purposes.

What do these tests mean in practice?

- It is not necessary to hold qualifications or licenses to carry on an economic activity. However, hobbies and private activities do not generally qualify as economic activities. Consider the facts – is there regular and ongoing activity which lends itself more to an economic activity?
- An economic activity must be carried out independently – meaning that employees and company directors are excluded. Sole traders carry out independent economic activities. Partners in a partnership may be seen as carrying out an economic activity independently of the partnership.
- Just because a business shuts down during a particular season (such as a water park closing in winter) or closes briefly to be refurbished doesn't mean there's no economic activity.
- Preparatory acts (such as acquiring premises, purchasing inventory or hiring staff) can indicate the commencement of an economic activity but objective evidence must be shown. Where there is an intention to carry on an economic activity but no costs have been incurred, it will not be considered to have started. An economic activity has ended when there are no further supplies and all steps have been taken to shut down the business.

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Contact us:



Mark Gamble
Senior Manager
mark.gamble@keypoint.com
+973 3833 8641



Raman Ohri
Senior Manager
raman.ohri@keypoint.com
+973 3516 2335



Dao Han Hung
Manager
daohan.hung@keypoint.com
+973 3907 79641



Tariq Haq
Manager
tariq.haq@keypoint.com
+973 3628 3351



AbdulRahman Bucheeri
Assistant Manager
abdulrahman.bucheeri@keypoint.com
+973 3937 7564

- If contractors are not operating under an employment agreement, they are carrying on an economic activity (even if operating in their own personal name) and should consider VAT registration requirements.
- If there is no intention to charge for services, there is no economic activity.
- Board members:
 - Carrying out core duties of a board member – not an economic activity
 - Carrying out other functions (such as consultancy services) – economic activity
 - Carrying out professional directorship services for a fee – economic activity
 - Appointed by virtue of shareholder rights – not an economic activity
- Charities and non-profits may be carrying on an economic activity - despite having no intention to make a profit - if they are carrying on activities that are commercial in nature (such as running a thrift shop). Receiving donations is out of scope for VAT.
- Dormant companies do not carry out economic activities.
- Passive holding companies – companies which hold shares and receive dividends in a passive capacity and may also provide long-term non-interest bearing loan capital to subsidiaries - are not carrying out an economic activity.
- Active holding companies – which hold shares in subsidiaries and receive dividends and also actively manage the subsidiaries for a consideration (such as management fees) - are carrying out an economic activity. Indicators of an active holding company include:
 - Provides management services
 - Incurs costs in addition to the legal and regulatory costs required to maintain registration
 - Has employees
 - Provides interest-bearing loans to subsidiaries
 - Licenses intellectual property to subsidiaries
 - Owns tangible assets
- Whether a joint venture (JV) is carrying out an economic activity depends on whether the JV is incorporated or unincorporated:
 - Incorporated JVs are carrying on an economic activity independent of the principals
 - Unincorporated JVs may be carrying on an economic activity and so may be required to register for VAT despite not being a legal entity
- Where a government department subcontracts a sovereign activity to a third-party, the third-party company needs to consider whether those activities are no longer made in a 'sovereign capacity' - meaning they are carrying on an economic activity and so are required to register for VAT.

Disclaimer: This sector spotlight is based on our review of the NBR's economic activities guide, our understanding of Bahrain's VAT legislation and the GCC framework agreement and general VAT principles and is for general information only. Seek professional advice in relation to your particular circumstances.