

Bahrain VAT | Construction and real estate

December 2020

Background

Under the Bahrain VAT Law, specific relief has been granted to the construction and real estate sector. While supplies related to construction of new buildings have been zero-rated, supply of bare land and buildings (whether by way of outright sale, rental or lease) has been made exempt. However, there are many exceptions as well as conditions associated with the beneficial VAT treatment. Therefore, contractors, sub-contractors, developers and property owners should consider the rules carefully to ensure they are fully compliant.

New construction projects

Contractors and sub-contractors supplying goods and services for new construction projects must carefully assess the nature and form of supplies and apply the correct VAT rate. Examples of standard rated and zero-rated supplies in relation to the construction of a new building:

- ✓ Sub-contractor supplying construction services along with building materials to the main contractor: the supply of construction services along with the building material should be zero rated.
- ✓ Sub-contractor supplying building materials only to the main contractor who will use this material to provide construction services: the supply of building materials without construction services should be subject to VAT at 5%.
- ✓ Engineering firm deputed engineers and surveyors to provide supervisory services in relation to a new building construction project: the supply of such services should be zero rated.
- ✓ Heavy machinery rental firm provides equipment on hire to the main contractor who will use this material to provide construction services: the equipment hire services should be subject to VAT at 5%.
- ✓ Sub-contractor provides landscaping services and constructs a swimming pool for a new residential project: such supplies should be subject to VAT at 5%.

The above examples are only illustrative, and each supply should be considered separately.

For instance, supply of ready-mix concrete will be treated as construction works subject to zero rate regardless of whether the supplier is providing any services, including pouring services. As you can see from the above the VAT treatments are complex and careful consideration needs to be given to each supply

'New building' definition

For contractors and sub-contractors to apply the correct VAT treatment, it is essential to examine whether the construction project is for a 'new building'. While the definition of building is broad enough to cover any residential, commercial or industrial buildings, structures such as bridges, elevated roads and flyovers will not qualify for the zero rating.

Further, a building may be considered as a new construction project if the project entails construction of an extension to a pre-existing building which substantially increases the capacity of the existing structure. Examples include addition of a new floor/basement, horizontal expansion by way of adding new rooms etc. It should be noted that refurbishment or improvement works will not qualify for the zero rating.

Zero rating certificate

Even though the VAT Law and Regulations do not explicitly prescribe any such requirement, the NBR has clarified that for applying the zero rating on new construction projects, the contractor/sub-contractor must be in possession of a certificate issued by the main contractor/property owner containing prescribed particulars. There have been instances where the zero-rating has been denied by the NBR upon failure to produce such certificate during VAT audits.

Bahrain VAT | Construction and real estate

Post-completion considerations

1. Retention payments

Once a construction project is certified as complete, a portion of the contract value is generally withheld by the client until expiry of the defects liability period. Any retention payments related to construction projects which were completed prior to implementation of VAT in Bahrain will be outside the scope of VAT. Further, the VAT liability obligations on retention will arise at the time when the retention becomes due for payment.

2. Snagging works

During the defects liability period, the client may direct the contractor to rectify any faults identified. Where such rectification is performed by the contractor without any additional consideration, no additional VAT implications will arise. However, where any additional consideration is charged for such works, VAT implications will have to be considered.

3. Post completion construction supplies

Once the completion certificate is issued in accordance with the contract, any further supplies made will not qualify for zero-rating. This includes any additional construction works, maintenance works and repairs.

GCC funded projects

In a seminar held in June 2019, NBR clarified the VAT treatment for supplies made in Bahrain under the GCC funded projects. All imports made for the execution of identified GCC funded projects will be exempt from VAT. Supplies made by the identified main contractors will be zero-rated, regardless of the nature of supplies. However, sub-contractors will need to determine whether their supplies will be eligible for the zero-rating as construction services in relation to new buildings. In addition to the above, NBR has set up a dedicated team for auditing and processing the refunds for contractors making supplies to the GCC funded projects. Formal guidance on VAT treatment of supplies made under GCC funded projects is still awaited.

Lease and sale of real estate

The sale or lease of residential (furnished or unfurnished) or commercial buildings and land is exempt from VAT. The exemption extends to:

- ✓ Supply of car parking space for a period of more than 1 month.
- ✓ Rental of a jetty which is a permanent and fixed structure made from material such as concrete.
- ✓ Serviced accommodation where the rental agreement is for a period of at least 1 year.

Under rental contracts, there may be an additional service charge for services for management services, utilities, telecommunications, internet, television, housekeeping etc. These additional service charges will be subject to VAT at 5%. However, where no additional charge is made for the above services, the entire rental amount will continue to be exempt. Therefore, it is essential for property owners to critically examine the terms of their agreements with tenants for allocating the appropriate VAT treatment.

The following have been specifically excluded from the real estate exemption:

- ✓ Access to hot desks and co-working spaces
- ✓ Grant of right to affix equipment or signage to land or buildings
- ✓ Short-term retail and promotional stands
- ✓ Hotel accommodation services
- ✓ Rental of a function room, hall or similar facility

Input tax recovery

Due to the exemption on real estate supplies, developers and property owners do not have the right to recover any input VAT incurred on purchases/expenses which are directly and exclusively attributable to the real estate supply.

Bahrain VAT I Construction and real estate

For instance, VAT incurred by a property owner on repairs/improvements to the property which is provided on an exclusive basis to a tenant in lieu of all-inclusive rent will not be recoverable by the property owner.

In cases where a separate service charge is payable by the tenant, input tax related directly to the services being provided in lieu of that charge should usually be recoverable as long as a direct nexus can be established.

An entity which is making taxable supplies in addition to exempt real estate supplies must identify common expenses which cannot be attributed directly to either the taxable or exempt revenue. Such expenses would include audit fee, legal expenses, procurements for cost centers such as finance, administration and human resources.

This document is for general information only and is not intended to address the circumstances of any specific scenario. Please seek professional advice in relation to your circumstances.

Once the common expenses are identified and VAT on such expenses is quantified, the entity is required to adjust the input tax based on the ratio of exempt revenue to total revenue for every tax period and make an aggregate adjustment annually.

These adjustments are often scrutinized by the NBR and entities are expected to keep proper record of expense allocation and basis of computation failing which the NBR may not accept the adjustment made by the taxpayer.

Conclusion

Given the complexity of transactions and allocation of VAT treatment, it is critical for contractors, sub-contractors, developers and property owners to assess their VAT position and monitor it on an ongoing basis to ensure compliance and readiness in case of an NBR audit.

Contact us:

**Philippe Norré**

Partner, Head of Tax & Corporate Services
T: +973 17201400
E: pnorre@kpmg.com

**Mubeen Khadir**

Partner
T: +973 17224854
E: mubeenkhadir@kpmg.com

**Ali AlMahroos**

Director
T: +973 17201459
E: aalmahroos@kpmg.com

**Omar Hisham**

Senior Manager
T: +973 17224807
E: sosaid@kpmg.com

**Adria Campbell**

Senior Manager
T: +973 17201403
E: abugeac@kpmg.com

**Shashank Chandak**

Manager
T: +973 17201462
E: shashankchandak@kpmg.com

**Hasan Khalaf**

Manager
T: +973 17222301
E: hakhalaf@kpmg.com

**Mansoor Al Wedaie**

Manager
T: +973 17224807
E: malwedaie@kpmg.com

<https://home.kpmg/bh>

KPMG Fakhro, a Bahrain partnership registered with the Ministry of Industry, Commerce and Tourism (MOICT), Kingdom of Bahrain and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.