

Bahrain VAT | Recoverability of input tax on capital assets

December 2020

Background

VAT is usually charged on purchase of capital assets. However, the recoverability of such VAT is not as straightforward. There are a number of considerations for registered businesses to consider when recovering input VAT incurred on capital assets.

Input tax recovery

Generally, a taxable person may recover the input VAT incurred subject to meeting certain criteria such as the expense being incurred for carrying out the economic activity, retaining the required documentation and that the input tax is deducted within the specified timeframe stipulated by the legislation. In addition to these requirements, the input VAT incurred should not be specified as non-recoverable in the legislation.

a taxable person shall deduct the input tax in the first tax year during which the capital assets are used for the first time.

When is a capital asset used for the first time?

In practice, businesses may be purchasing different components of a business asset before fully recognizing it. This is very common especially in both the construction as well as oil and gas industries where business assets require a period of time in order to be operational. In such cases, the cost of items is recognized as an asset only if it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably.

From an accounting perspective, prior to recognizing the costs as an asset, these costs are accumulated as work-in-progress until the asset is placed into service and then transferred to the relevant long term asset account. Depreciation will begin once the asset is put into service. Based on that, it is imperative that the 'first use' of the asset occurs when the asset is capitalized which gives rise to the right to input tax deduction.

However, the VAT compliance functions within registered businesses have been mostly setup in a way where the input VAT is claimed based on documentation i.e. once a compliant tax invoice is received or a customs import declaration is in hand. This poses a serious compliance risk from a VAT perspective as the input VAT is being claimed prior to the 'first use' of the business asset.

What constitutes a capital asset?

The Bahrain VAT Law defines a capital asset as a tangible or intangible asset that is assigned by the taxable person for long-term use as a business instrument. If we convert this to simple accounting terms, a capital asset would be tangible or intangible asset that is capitalized by a business (i.e. to be expensed over the useful life of the asset).

In order to decide the cost to be capitalized, a number of components are taken into consideration depending on the type of asset. These typically include purchase price, construction cost, import duties, inbound freight and handling, site preparation, installation and assembly and asset start-up testing among other costs.

When does the right to deduct input VAT on capital assets arise?

In accordance with Article 60 paragraph C of the Bahrain VAT Executive Regulations,

Bahrain VAT | Recoverability of input tax on capital assets

Conclusion

It is crucial for businesses to consider the various type of business assets and the asset capitalization policies in order to determine the tax period in which the entitlement to input tax deduction arises. Taxpayers may need to consider enforcing control over input tax deduction of capital assets using trackers to monitor the stages of the work-in-progress and when the capital asset is used for the first time.

The foremost issue is whether businesses have considered this while claiming input tax previously incurred on capital assets as there may be penalties imposed for incorrect input tax recovery. The complexity of capital asset schemes from a VAT perspective requires attention from taxpayers in order to ensure that they are fully compliant with the VAT legislation.

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.

Contact us:

**Philippe Norré**

Partner, Head of Tax & Corporate Services

T: +973 6673 8060

E: pnorre@kpmg.com

**Mubeen Khadir**

Partner

T: +973 3222 6811

E: mubeenkhadir@kpmg.com

**Ali AlMahroos**

Director

T: +973 3434 3440

E: aalmahroos@kpmg.com

**Omar Hisham**

Senior Manager

T: +973 3840 7759

E: sosaid@kpmg.com

**Adria Campbell**

Senior Manager

T: +973 3540 2402

E: abugeac@kpmg.com

**Shashank Chandak**

Manager

T: +973 3553 1905

E: shashankchandak@kpmg.com

**Hasan Khalaf**

Manager

T: +973 3636 6462

E: hakhalaf@kpmg.com

**Mansoor Al Wedaie**

Manager

T: +973 3998 8098

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.