

Bahrain VAT - Transfer of a going concern

The Bahrain National Bureau for Revenue released a VAT guide on transfers of a going concern (TOGC) recently. We highlight below the key considerations.

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Background

VAT is normally charged on the sale of business assets. However, if a business is transferred as a going concern, then such a supply is outside the scope of VAT. A TOGC is not treated as a supply of goods or services and therefore no output tax is chargeable on the business sale thus limiting any impact on cash flow for the purchaser. For a business sale to be treated as a TOGC certain conditions need to be met.

Key conditions

1. The transfer must include all or part of a business which the transferee will be able to operate on an independent basis

The effect of the transfer must be to put the new owner in possession of a business which can be operated as such. Selling only a few assets on their own will not constitute a TOGC.

In case of a part transfer, that part must be capable of separate operation for it to constitute a TOGC. It does not matter whether it will, in fact, be operated separately from any other business the new owner carries on. A progressive transfer of assets may be permissible. Assets transferred that will not be used by the transferee in the ongoing business will not be covered by the TOGC provisions.

2. The transferor must be registered for VAT

The transferor must be a taxable person (i.e. registered or liable to be registered for VAT), on or before the date of the transfer, for the transaction to qualify as a TOGC.

Following the transfer of the TOGC, the transferor should assess their requirement for VAT de-registration.

3. The transferee must be registered for VAT, or liable to be registered as a result of the TOGC

For the transaction to qualify as a TOGC, the transferee must be effectively registered for VAT purposes with the NBR, on or before the date of the transfer, or become obliged to register as a result of the TOGC. In determining whether the transferee is a taxable person, the turnover of the seller must also be considered. If the transferee is not a taxable person, then they must register for VAT within 30 days of the transfer taking.

NBR has not specified any special VAT registration requirements for a non-resident purchaser who acquires a business as part of a TOGC. A non-resident business is required to register for VAT immediately if they make any taxable supplies in the Kingdom of Bahrain or they expect to do so within the next 30 days (the Bahrain VAT registration threshold does not apply).

4. The transferee must immediately use the assets acquired to conduct the same or a similar economic activity

Where the transferred assets are acquired with the intention of using them (immediately or in the future) for an activity or a business that is different from the activity previously carried out by the transferor, then the transfer would not qualify as a TOGC.

There should be no significant break in the normal trading pattern before or immediately after the transfer. A short period of closure which does not significantly disrupt the existing trading pattern, for example, for redecoration or maintenance will be ignored. If the intention is only to carry on the business for a short time before changing the nature of the business, then the TOGC provisions may not apply.

The business, or part of the business being transferred must be a 'going concern' at the time of transfer. This does not necessarily imply that the business has to be commercially viable. For example, it may have been scaled down due to financial difficulties or in anticipation of sale or be trading under a liquidator.

5. Both the transferor and the transferee must notify the NBR of the transfer

When a transfer qualifies as a TOGC, the transferor and the transferee must both, independently, notify the NBR of the transfer within 30 days of the transfer. The notification must be submitted in the prescribed NBR form. Failure to do so will deem the transfer as a taxable supply.

What must be transferred?

TOGCs typically comprise the transfer of all the assets (and liabilities) required to undertake the business such as:

- Tangible assets – land, buildings, vehicles, equipment, trading stock, cash
- Intangible assets – software, goodwill and intellectual property
- Liabilities – typically the purchaser would assume the obligation to pay any debts as at the date of the transfer

Other Points on TOGC

Transfer of exempt assets

Transfer of real estate as well as issue or transfer of ownership of securities (equities or debt) are considered VAT exempt transactions in Bahrain. However, when these assets form part of a TOGC transaction, their transfer will be outside the scope of VAT in accordance with the TOGC provisions. It is important to note here that in case the transferor's economic activity only comprises of VAT exempt transactions, the transferor will not be eligible for a VAT registration and thus the TOGC conditions will not be met.

TOGC within a VAT group

A VAT group is considered a single taxable person for VAT purposes. All supplies between members of the VAT group are deemed to be made to and by the representative of the VAT group. Therefore, transactions between members of a VAT group, including those that may otherwise fall within the TOGC provisions, will be outside the scope of VAT.

TOGC to a VAT group

For the TOGC provisions to apply on a transfer of assets to a VAT group, it is important that these assets are used to make supplies outside the VAT group and are not merely consumed within the VAT group, unless it is to make supplies to other VAT group members, who, in turn, make supplies to persons outside the VAT group.

Input VAT deduction

Although a TOGC is not a supply for VAT purposes, this does not prevent the deduction of input tax on related expenses, such as consultancy fees and legal fees in accordance with the normal input VAT recovery rules.

Bad debts

Transferees are not entitled to claim bad debt relief for supplies that were previously made by the transferor.

Capital assets under a TOGC

Under a TOGC, any capital items included as part of the transfer are not 'sold' for the purposes of the capital goods scheme (CGS) and therefore the normal CGS sale adjustment does not apply. The responsibility for applying the capital goods scheme to any capital item transferred passes to the new owner for any remaining intervals.

Successive transfers

There must not be a series of immediately consecutive transfers of the business. For example, where A sells its business to B who immediately sells the business to C, B would have not carried on the business. As a result, B can neither receive nor make an onward supply of the business under the TOGC provisions.

Contractual issues

If there is any doubt about whether a sale is a TOGC or not, then the seller could be exposed to a liability for VAT if it is not charged when it should have been, and the purchaser is exposed to not being able to recover VAT if the VAT had been wrongly charged in the first place. Therefore, it is best practice to include clauses to protect both the purchaser and seller.

Contractual issues (cont.)

Typically, the sale contract will include a clause stating the purchaser agrees to pay VAT on the transfer in the event the NBR rule does not accept the business sale is a TOGC and that the seller agrees to supply a VAT invoice in such a case. In some cases, the vendor may also hold the amount of the VAT otherwise payable in escrow until the transaction is complete and there is confirmation that the TOGC provisions apply.

Conclusion

It is important to consider the substance of the transaction to ensure it qualifies as a TOGC with consideration given to all the surrounding circumstances. The key question is whether the effect of the transaction was to put the transferee in possession of a going concern, the activities of which they could carry on without interruption. TOGCs can be complicated and VAT payers need to ensure that appropriate legal documents are in place to effect the transfer.

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