

VAT for Beginners: Part 1

# Preparing for Value Added Tax in Bahrain



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## What is VAT?

- Value Added Tax (VAT) is a tax payable on supply of goods or services by a 'business entity' ('Supplier') to another 'business entity' or 'end customer' ('Buyer').
- For example, sale of a Mobile phone (goods) in the Super market or buying a movie ticket at a Cinema hall (entertainment services), subject to other conditions, will attract VAT
- This tax is generally calculated on the total value of goods or services that is charged by the Supplier from the Buyer.
- VAT is an international standard that is implemented in 180+ countries across the globe.
- It is one of the most widely used method of "Indirect Taxation" with credit being allowed of tax (VAT) paid on purchases to offset the tax payable on sales.



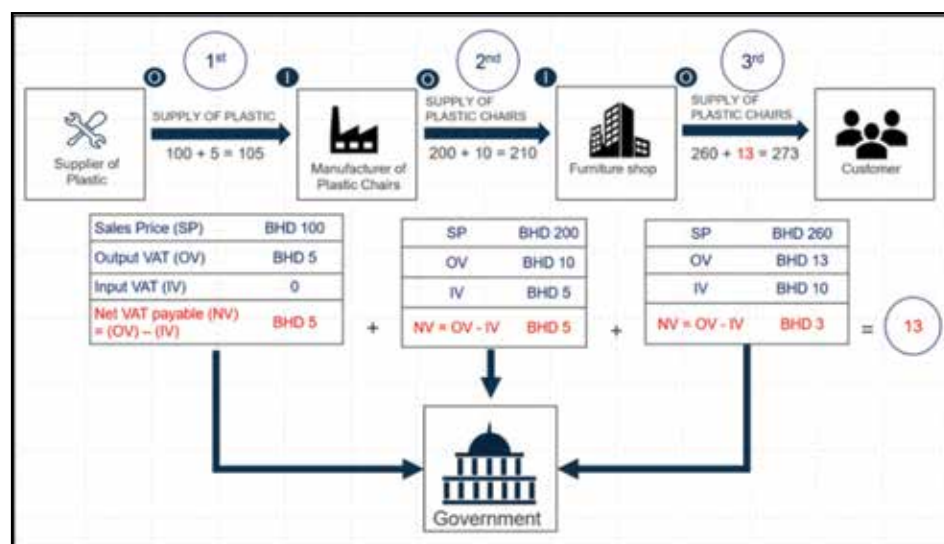
## Why is VAT called an "Indirect Tax" or "Consumption Tax"?

- VAT is a tax on the gross price for sale or supply of goods or services.
- In almost all cases, the liability to deposit VAT with Government is of the Seller.
- However, the Seller is allowed to collect VAT from its Buyer.
- Accordingly, its always the Buyer and most likely the end-customer in the supply chain which effectively (or Indirectly) bears the burden of VAT.
- Further, it can be said that VAT is tax on goods or services which are ultimately consumed in the economy.
- Hence for above reasons, VAT is called "Indirect Tax" (borne indirectly by Buyer) or "Consumption Tax" (tax payable on consumption which is assumed to coincide with supply)

## How does VAT work?

- Understanding how VAT works is important because it will help you understand how VAT should be calculated; how much VAT is to be collected from Buyers, how much VAT is to be paid.
- Different players / businesses in the supply chain collect and account for VAT at each point of supply in the transaction chain. Ultimately, the total cost of VAT charged is borne by the end-consumer.
- To understand this, it is important to understand the following 2 terms:
  - Input VAT – VAT charged by a vendor to a Business entity for supply of goods / services by the vendor to the Business entity
  - Output VAT – VAT payable by a Business entity on supply of goods or services by the said Business entity to its Buyer
- Output VAT of Seller is Input VAT of Buyer
- For settlement of tax, Output VAT is adjusted by the value of Input VAT paid to the vendor.
- Below is a demonstration on how VAT works:

- In the example, there are 3 sales:
  - 1st Sale: Sale of 'plastic' from vendor (Seller) to Manufacturer of Plastic Chairs (Buyer)
  - 2nd Sale: Sale of 'plastic chair' by Manufacturer of Plastic Chairs (Seller) to Furniture Shop (Buyer)
  - 3rd Sale: Sale of 'plastic chair' by Furniture Shop (Seller) to End customer (Buyer)
- For the 1st sale, the Seller will charge BHD 100 as Sales Price and BHD 5 as VAT. Buyer can take Input VAT credit of BHD 5
- For the 2nd sale, the Seller will collect BHD 200 as Sales Price and BHD 10 (5% Output VAT) from Buyer. Buyer will pay BHD 210 to Seller. Seller will deposit BHD 5 (Output VAT of BHD 10 minus Input VAT of BHD 5) with Government.
- For the 3rd sale, Seller will collect BHD 260 as Sales Price and BHD 13 (5% Output VAT) from Buyer. Buyer will pay BHD 263 to Seller. Seller will deposit BHD 3 (Output VAT of BHD 13 minus Input VAT of BHD 10) with Government.



Sale	Sales price	Output VAT	Amount collectible from Buyer	Input VAT	Net VAT payable to Government
1 <sup>st</sup> Sale	100	5	105	-	5
2 <sup>nd</sup> Sale	200	10	210	5	5
3 <sup>rd</sup> Sale	260	13	273	10	3
<b>TOTAL VAT</b>					<b>13</b>

- Hence the Government collects BHD 5 + BHD 5 + BHD 3 = BHD 13. This is nothing but 5% of BHD 260 (final sales price).
- VAT system by providing credit of Input VAT charged by the vendor, prevents cascading of taxes i.e. tax on tax. This helps controls the price of the goods or service and hence controls inflation.

(This is part 1 of a multi-part series presented by award-winning VAT Experts Dhruva Advisors – Bahrain. Part 2 of the series to be published on Wednesday will discuss the rate of VAT and the goods and services liable to VAT.)

\*Note: I = Input; O = output; SP = Sales Price; OV = Output VAT; IV = Input VAT; NV = Net VAT Payable

\*\*\*This series is only for educational purposes. To receive advice for a specific business scenario, please consult a Tax expert.