FAQs on the Inclusive Framework BEPS Agreement

August 2021

BEPS 15 Actions

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What is BEPS?

Base Erosion Profit Shifting (BEPS) refers to tax planning strategies used by companies operating across different jurisdictions to exploit gaps and mismatches in tax rules to avoid paying tax.

What is the OECD/G20 Inclusive Framework on BEPS?

139 countries (including Bahrain, Oman, Qatar, Saudi Arabia and the United Arab Emirates) have signed up to the Inclusive Framework (IF) on BEPS to implement 15 actions to tackle tax avoidance, improve coherence of international tax rules and ensure a more transparent tax environment.

What are the BEPS 15 actions?

The 15 actions above equip governments with rules and instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created.

What has Bahrain done about BEPS?

Bahrain has:

– implemented Economic Substance Rules (ESR) (BEPS Action 5);

– signed the Multilateral Instrument (BEPS Action 6 and 15);

– introduced Country by Country (CbC) Reporting (BEPS Action 13);

– implemented a Mutual Agreement Procedure (BEPS Action 14); and

– implemented the Common Reporting Standard (CRS) to allow the Automatic Exchange of Information and Ultimate Beneficial Ownership (UBO) rules.

More recently, on 1 July 2021, Bahrain was one of the130 IF member countries to approve a statement providing a framework for international tax reform.

What does the 1 July 2021 IF statement say?

The statement sets forth the key terms for an agreement of a two-pillar approach to reforms. It also calls for a comprehensive agreement by the October 2021 G20 Finance Ministers and Central Bank Governors meeting, with changes coming into effect in 2023. Pillar One of the agreement is a significant departure from the standard international tax rules of the last 100 years, which largely require a physical presence in a country before that country has a right to tax. Pillar Two secures an unprecedented agreement on a global minimum level of taxation which has the effect of stipulating a floor for tax competition amongst jurisdictions.

What is Pillar One and Pillar Two?

While Pillar One is focused on nexus and profit allocation (with wider transfer pricing and value creation related concepts), Pillar Two (also referred to as the Global Anti-Base Erosion (GloBE) proposal) is focused on a **Global Minimum Tax** (GMT) for large multinationals, intended to address remaining BEPS issues.

Read KPMG's summary and initial analysis of Pillar One and Pillar Two.

What is a global minimum tax?

Pillar Two proposes that international businesses pay a GMT of 15%. There are four rules:

1. **Income inclusion rule (IIR):** subjects foreign income of branches and controlled entities to an agreed minimum tax in the parent jurisdiction.
2. **Undertaxed payments rule (UTPR):** denies deduction or imposes source-based taxation for payments to a related entity if that payment was not subject to tax above the minimum tax rate.
3. **Switch-over rule (SOR):** applies where a permanent establishment is "undertaxed," switching off a treaty-based exemption in the Head Office jurisdiction and replacing it with a credit-based method of taxation.
4. **Subject to tax rule (STTR):** complements the UTPR and would deny treaty benefits for certain deductible intragroup payments that are subject to no or low rates of taxation in the recipient jurisdiction.

Is there a threshold set for the GloBE rules?

The statement provides that the GloBE rules will apply to Multinational Enterprises (MNEs) with revenues exceeding the €750m (approx. BHD342m) threshold as determined under BEPS Action 13 (Country by Country reporting).

Countries are, however, free to apply the IIR to MNEs headquartered in their countries whose revenue fall below this threshold. Some countries are likely to adopt a lower threshold as the number of MNEs caught within the net would otherwise be very small.

How does the IIR operate?

IIR is the main rule which will operate in a similar way to the Controlled Foreign Company (CFC) rules that currently exist in many jurisdictions.

The IIR would trigger an inclusion at the level of the shareholder when the income of a CFC is taxed at below the GMT of 15%. The shareholder would be subject to a "top-up tax" to bring the low-taxed entity's effective tax rate (ETR) up to the agreed minimum.

In simple terms, the IIR imposes a top up tax on the Ultimate Parent Entity (UPE) in relation to the profits of group companies that are taxed at an effective rate of below the GMT of 15%.

How does the UTPR operate?

The UTPR is a secondary rule and will apply where the GMT is below 15% and the IIR has not been applied by the jurisdiction in which the holding company or intermediate holding company is. The UTPR will deny a tax deduction or will impose source based taxation (for example withholding tax) for a payment to a related party if that payment was not subject to tax at or above the GMT of 15% under the IIR.

How does the SOR operate?

In case a double tax treaty results in the parent jurisdiction exempting the income of a Permanent Establishment (PE) and the profits attributable to the PE in the other jurisdiction are low taxed profits, the SOR would allow to switch from the exemption to the credit method. This means that there will be a credit given for tax paid rather than exempting the profits.

How does the STTR operate?

The STTR will complement the UTPR by subjecting to withhold tax or other tax at source for certain payments (such as interest, royalties, franchise fees) that present a high risk of profit shifting to low-tax jurisdictions.

What is Bahrain likely to do?

Countries, such as Bahrain, that only have a limited Corporate Income Tax (CIT) or a CIT below the GMT of 15% will need to make some key decisions:

– Implement the IIR and CIT on all businesses; or

– Implement the IIR and CIT on select businesses.

If it does nothing, profits generated by companies in Bahrain could be subject to tax in other jurisdictions. In essence, Bahrain will lose out on taxing rights. For example:

– An UPE located in Bahrain may still end up paying top up tax in another jurisdiction on the profits generated locally;

– An UPE in a country that has implemented the IIR with subsidiaries in Bahrain would include and pay the top up tax in respect to the low taxed Bahrain subsidiaries – Bahrain would concede the tax revenue that may have been generated from the profits of the Bahrain subsidiaries to another jurisdiction.

Is Bahrain likely to not take any action?

Bahrain is already committed to the IF having introduced CbCR and ES rules. Bahrain will want to continue to ensure that it is not included in the EU Blacklist of Uncooperative Jurisdictions – therefore, it is likely that Bahrain will be seriously considering the implementation of the IIR and CIT.

What should businesses in Bahrain do?

Businesses with a UPE in the GCC, or MNEs with subsidiaries in the GCC, should monitor the developments around BEPS Pillar Two, as its implementation is likely to have a significant impact on Bahrain and the regional tax landscape.

Whilst the IF statement provides that the GloBE rules will apply to MNEs with revenues exceeding the €750m threshold (approx. BHD342m) as determined under BEPS Action 13 (Country by Country reporting), countries are free to apply the IIR to MNEs headquartered in their countries whose revenue fall below this threshold.

We recommend that Bahrain businesses conduct at least a preliminary analysis of the impact the introduction of a CIT will have on them.

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

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