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Tax Insights

Will Bahrain introduce Corporate Income Tax?

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Background

With the United Arab Emirates announcing the introduction of a Corporate Income Tax (CIT) effective mid 2023, here are some questions for Bahrain businesses to consider.

What is Bahrain likely to do?

Bahrain is committed to the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) having already introduced Country by Country (CbC) Reporting (BEPS Action 13) and Economic Substance (ES) rules (BEPS Action 5).

If Bahrain does nothing on CIT, under the Global Minimum Tax (GMT) rules that are to take effect from 2023, profits generated by Bahrain companies could be subject to tax in other jurisdictions. In essence, Bahrain will lose out on taxing rights. For example:

- An ultimate parent entity (UPE) located in Bahrain may still end up paying top up tax in another jurisdiction on the profits generated in that jurisdiction;
- An UPE in a country that has implemented the GMT Income Inclusion rule with subsidiaries in Bahrain would include and pay the top up tax in respect to the low taxed Bahrain subsidiaries – Bahrain would have to concede the tax revenue that may have been generated from the profits of the Bahrain subsidiaries to another jurisdiction.

In addition, Bahrain will want to continue to ensure that it is not included in the European Union Blacklist of Uncooperative Jurisdictions – **therefore, in our view, it is likely that Bahrain will also introduce a CIT**.

What are some of the key impact areas under a CIT?

Related party transactions must reflect the taxable income that would have arisen if the transactions had been carried out at arm's length (with a third party). Related party transactions between entities within a group that have different tax profiles (such as loss-making entities or entities subject to different effective tax rates) may attract more scrutiny from a tax authority as there could be motive to shift profits to other group entities that are subject to a lower tax rate.

A CIT regime introduces several compliance concepts (transfer pricing, consolidation rules, interest deductibility limitations) so businesses will need to ensure that their current **systems** will be able to handle these requirements.

Existing structures may or may not be tax effective. Even before a CIT is introduced, businesses can evaluate their existing operations and structures to see if they would be tax effective and consider any optimisation opportunities well before any transitional rules or restrictions are announced along with the introduction of a CIT.

As different **depreciation** rates will be applied for tax and accounting purposes, the tax base and carrying amount of assets may differ.

Income and expenses may be recognised in different periods for tax and accounting purposes and specific income and/or expenses may not be recognised for tax purposes but recognised for accounting purposes, or vice versa.

The treatment of **capital gains and losses** will vary for the purposes of CIT and accounting. Tax losses in a particular year may be available to offset the taxable income in later years. This will also result in differences between accounting profit and taxable income (or the carry forward tax loss).

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What should Bahrain businesses be doing now to ensure a no-surprise transition to operating within a CIT environment?

Bahrain businesses have historically been operating under a no domestic CIT regime and the introduction of a CIT regime will be a significant disruption to the status quo with far reaching financial and commercial implications. Businesses should focus on the following main areas:

- The current role of the tax function in the organization
- Legal structure, business model, and capital structure rationalisation
- Adequate resources and capabilities within the finance function
- Systems and technology infrastructure used by finance and whether it can be leveraged for tax and consider any updates if required
- Polices and controls for governance, strategy and reporting

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

This document 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.

To know more about how we can assist, contact us:

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