KPMG

Tax Insights

Introduction of Corporate Income Tax in Bahrain

May 2023

Background

On 23 May 2023, the Bahrain Minister of Finance and National Economy, during the weekly parliamentary session stated (as reported by the local press):

"It is a global direction to impose corporate taxes and Bahrain is committed to complying with the move…We firmly believe that companies should contribute to the sustainability of the economy and financial development of the country…The issue is a matter of when, not if, as we continue to work with the OECD [Organisation for Economic Co-operation and Development] on getting things right as we ensure that it wouldn't have an economic impact that affects employment, economic growth and investments."

What would CIT in Bahrain look like?

It is likely that Bahrain will implement a standard Corporate Income Tax (CIT) regime similar to other jurisdictions. Based on the United Arab Emirates (UAE) CIT legislation, we have set out below some key features that one may expect to see in the Bahrain CIT law:

– CIT is likely to **apply** to all commercial activities. Entities engaged in the exploration, production or refining of hydrocarbons may be excluded as they are already subject to a specific tax regime. **Small business relief** may be available to businesses with revenues below a certain threshold. Further, individuals earning employment income or passive investment income may potentially be excluded from CIT.

– We expect the **rate** to be in the range of 5% to 10% for businesses falling below the Base Erosion Profit Shifting Pillar II threshold (approx. BHD 342 million). For businesses above that threshold as well as Bahrain subsidiaries/branches that are part of multinational consolidated groups exceeding such threshold, we expect a tax rate commensurate with the Global Minimum Tax (GMT) rate of 15%.

– **Capital gains** from disposal of assets are likely to be taxed. There may be a capital gains exemption available subject to meeting certain conditions (for example, for entity reorganizations).

– A **participation exemption** may apply to dividends or capital gains received from qualifying foreign or local subsidiaries on the basis that this income has already been taxed.

– **Withholding tax (WHT)** may apply on payments (such as dividends, interest, royalties, management fees) to non-residents. The UAE prescribes a WHT rate of 0% but Saudi Arabia and other GCC countries impose WHT ranging from 5% to 20%.

– **Tax depreciation rates** generally differ from depreciation rates used for accounting purposes. As a result, the tax base and book value of capital assets may differ.

– Personal/recreational expenses and/or payments to related persons will be **disallowable** from a tax perspective.

– Carry forward of **tax losses** may be available to offset taxable income of future tax periods or against taxable income in other group entities, subject to meeting conditions.

– Any tax (including WHT) paid in a foreign jurisdiction may be available as **foreign tax credit** for offsetting against the CIT liability in Bahrain. This will be subject to conditions prescribed in Double Taxation Avoidance Agreement (DTAA) between Bahrain and the relevant foreign jurisdiction.

– The Bahrain CIT regime may allow group entities to form a **tax consolidated group** (different from accounting consolidation) and be treated as a single taxable person. Whilst certain jurisdictions including the UAE, Australia and certain EU countries allow tax grouping for CIT purposes, many other jurisdictions including KSA and Oman in the region do not allow tax grouping.

- Specific **transfer pricing** rules will apply to ensure that domestic and cross border transactions between related parties are carried out at arm's length (at market value) to prevent any manipulation of taxable income.

- Taxpayers may be expected to prepare and maintain **stand alone financial statements**.

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 the tax authority as there could be a 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.

- **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. This will also result in differences between accounting profit and taxable income (or the carry forward tax loss).

What should Bahrain businesses be doing now ?

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:

- Impact a CIT will have on business profits and therefore return to shareholders
- The current role of the tax function in the organization
- Legal structure, business model, and capital structure rationalization
- Adequacy of resources and capabilities within the finance and accounting function
- Existing systems and technology infrastructure used by the business and whether these can be leveraged for tax and consider any updates if required
- Polices and controls for governance, strategy and reporting

We 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:

Mubeen Khadir
Partner
Head of Tax and Corporate Services
KPMG Fakhro
☎ +973 3222 6811
mubeenkhadir@kpmg.com