KPMG

Bahrain Corporate Income Tax

How to calculate taxable income?

Background

On 23 May 2023, the Bahrain Minister of Finance and National Economy confirmed the introduction of Corporate Income Tax (CIT) in Bahrain during the weekly parliamentary session. We expect that Bahrain will implement a standard CIT regime similar to other jurisdictions with a rate in the range of 5% to 10% for businesses falling below the Base Erosion Profit Shifting Pillar II threshold (approx. BHD 342 million) and follow the Global Minimum Tax (GMT) rate of 15% for businesses above that threshold (including Bahrain subsidiaries/branches that are part of multinational consolidated groups exceeding such threshold).

With the UAE implementing CIT from 1 June 2023, we have entered a new era for tax in the region – Bahrain is currently the only GCC country without a broad-based CIT. Given the Bahrain CIT is likely to apply to all commercial activities with limited exclusions, this will be a paradigm shift for Bahrain businesses. Key stakeholders in Bahrain businesses will need to ensure their business and systems are ready for the introduction of CIT in Bahrain.

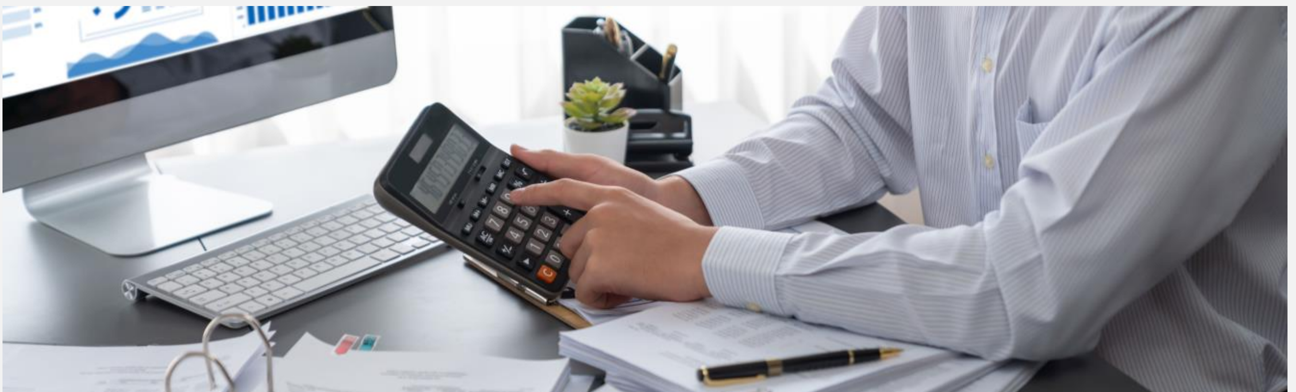
What is CIT?

Corporate Income Tax, also referred to as Business Profits Tax, is a direct tax levied on the ‘taxable income’ earned by a taxable person during an annual tax period. CIT liability is generally calculated on a self-assessment basis by filing an annual CIT return which may be audited by the tax authority. In a Bahrain context, a taxable person could include a company, an establishment, a Bahrain branch of a foreign company, an individual (with or without a commercial registration) carrying on a business.

How is ‘taxable income’ calculated?

The starting point for calculating taxable income is a taxable person’s accounting profit/loss as per the financial statements. The accounting profit/loss is then subjected to certain adjustments (additions & deductions) to determine the taxable income. These adjustments fall under two categories - timing differences and permanent differences. Timing differences are differences between taxable profit and accounting profit that are given effect in one period and reversed in subsequent periods whereas permanent differences are given effect in one period but are not reversed in subsequent periods.

We have outlined below some key adjustments to the reported accounting profit/loss which may increase or decrease the taxable income along with an overview of the CIT treatment based on general principles and what is prescribed under the CIT laws of some of the other GCC countries.



Adjustable item	CIT treatment
Fines & penalties	Almost universally a non-deductible expense. Some jurisdictions allow a deduction for compensation paid for breach of contract.
Donations	Generally deductible where it is paid to a ‘qualifying’ charitable organization (as defined in the CIT law). Some jurisdictions limit the deductible amount to a fixed percentage of gross income. For example, Oman limits it to 5% of gross income subject to it being paid to a ‘specified’ institution.
Entertainment expenses	Almost universally a non-deductible expense. Some countries like the UAE may allow a deduction for up to 50% of the entertainment expense subject to meeting certain conditions.
Provisions	Generally, a non-deductible amount unless the provision has been incurred. The CIT law will prescribe what is considered to have been incurred. From a CIT perspective generally, there must be a commitment or obligation to pay the actual expense (it cannot just be a provision for a future expense that may not be incurred).
Depreciation	Almost universally, a deductible expense to the extent allowed by the CIT legislation. The CIT law will prescribe the tax depreciation rates for each asset category as well as the method of depreciation (straight line or declining balance). Some countries like the UAE allow deduction based on accounting depreciation rates and method whereas countries like the Kingdom of Saudi Arabia (KSA) prescribe specific tax depreciation rates to be used.
Related party payments	Dividends and other payments to shareholders and related parties are generally not deductible for tax purposes. Some countries may allow a deduction for related party payments up to a limit prescribed in the legislation. For example, in Oman, deduction for related party payments is allowed up to certain caps prescribed in the legislation whereas the KSA denies deduction for any payment made to a shareholder or related party and the UAE allows deduction subject to meeting the arm’s length or market value test and other conditions. A deduction is generally allowed for payments for services received from related parties (for example, interest on loans from related parties) provided the transactions are carried out at on an arm’s length basis.
Interest	Interest payments under financing arrangements for business activities are generally tax deductible. Deduction for interest payments to related parties will be subject to transfer pricing rules/arm’s length principles. Certain jurisdictions prescribe an upper limit for deduction of interest expenses which may be calculated as a percentage of gross income (UAE) or based on a prescribed formula (KSA). In certain jurisdictions, deduction of interest expense is subject to maintaining a specified debt-to-equity ratio.
Foreign tax credits (FTC)	FTC of taxes paid in a foreign country is generally available for reduction of CIT liability. The conditions and mechanism for utilization of FTC may be prescribed under the relevant Double Tax Avoidance Agreement or the local CIT law.

Adjustable item	CIT treatment
Head office expenses	Local branches/permanent establishments may allocate certain expenses towards their foreign head offices for management services. Such expenses are generally not deductible when computing the taxable income of the local branch/permanent establishment. However, in certain jurisdictions, such expenses are deductible subject to prescribed limits. For example, in Kuwait and Qatar, such expenses are deductible up to a specified percentage of the entity's revenue.
Tax losses carried forward	Tax losses incurred in a particular tax period are generally deductible against the taxable income of future tax periods subject to conditions. For example, in the UAE, carried forward tax losses can be used to offset up to 75% of the taxable income in a future tax period. Other jurisdictions, like Kuwait and Qatar, prescribe an upper limit on the number years for carry forward of tax losses after which the tax losses lapse. Tax losses will generally also be lost where there is a change in ownership or change in business activity of the entity.
Exemptions	Dividends received from/ capital gains from sale of shares in qualifying foreign or local subsidiaries are generally exempt. Further, capital gains arising from business restructuring or sale of a business as a going concern are also generally exempt. Other special exemptions may be provided for specified businesses/activities.
Employee benefits	Generally, a deduction for employee salaries and benefits is available subject to any restrictions on payments to related parties. In some jurisdictions, benefits given to employees may be deductible subject to conditions and limits. For example, in the KSA, school fees paid by a company for children of employees are tax deductible if this benefit is stated in the employment contract and the fee relates to a local licensed school.

What does the above mean for my business?

We have set out below a simplified example of taxable income calculation. We have assumed an entity reported an accounting profit of BHD 10,000,000 which included certain non-deductible items from a CIT perspective.

Particulars		Amount (BHD)
A.	Accounting profit	10,000,000
Add:	Fines and penalties	150,000
Add:	Entertainment expenses	50,000
Add:	Accounting depreciation	1,500,000
Less:	Tax depreciation	1,000,000
Add:	Payments to shareholders and other related parties	1,500,000
Add:	Provisions (which did not satisfy conditions for being deductible)	1,000,000
B.	Taxable income	13,200,000
C.	CIT liability (assumed 10% CIT rate)	1,320,000
D.	Accounting profit after tax (A minus C)	8,680,000

What should businesses be doing now?

As can be seen from the above, CIT will have a direct impact on the return to shareholders of a company. A company that is reporting an accounting loss may end up in a taxable position and have to still pay CIT. Therefore, Bahrain businesses should focus on the following:

A. Assessment and planning
- Conduct CIT impact assessment on an as-is basis
- Review legal structure, current business operations and future business plans
- Review and identify risks in relation to related party transactions

B. Implementation (once law and regulations are released)
- Consider impact of transitional rules
- Seek clarification on ambiguities or uncertain tax positions
- Review impact of tax accounting adjustments
- ERP setup to support tax calculation and tax return preparation

C. Administration (once law and regulations are released)
- Tax registration
- Tax filing process
- Transfer pricing documentation
- Preparing for tax audits/assessments

For a detailed discussion on how the above may impact your business, contact us.

Mubeen Khadir
Partner - Head of Tax & Corporate Services
T: +973 3222 6811
E: mubeenkhadir@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2023 KPMG Fakhro, a Bahrain partnership registered with the Ministry of Industry and Commerce (MOIC), Kingdom of Bahrain and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.