

Corporate Income Tax in Bahrain

What is Transfer Pricing?

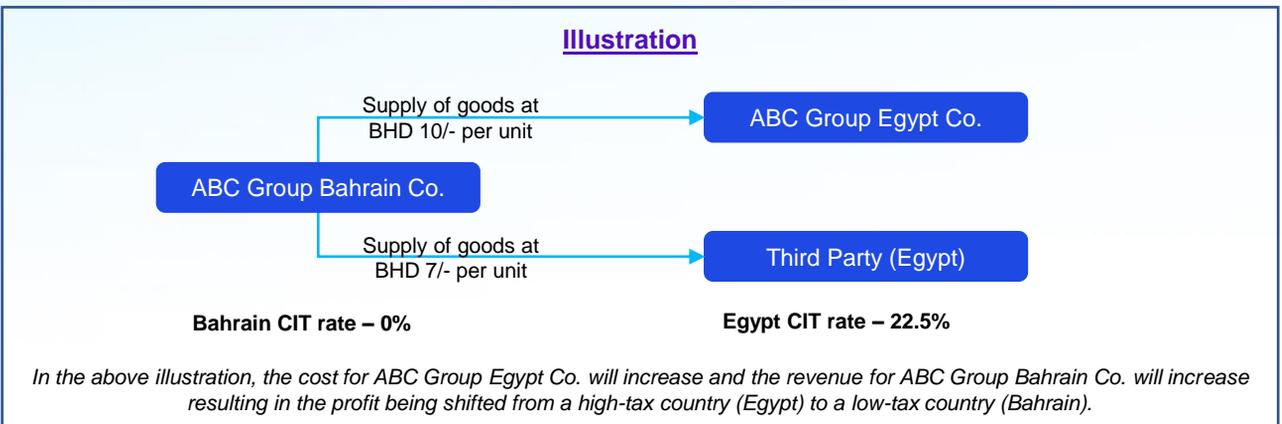
Background

On 23 May 2023, the Bahrain Minister of Finance and National Economy (MoFNE) confirmed the introduction of Corporate Income Tax (CIT) in Bahrain during the weekly parliamentary session.

According to [local news reports](#), the Bahrain Council of Representatives (lower house) / (مجلس النواب) has been discussing the implementation of a CIT. The Minister met with the Financial and Economic Affairs Committee of the Council of Representatives to discuss plans for widening the scope of taxes and the introduction of a CIT regime in Bahrain. It was reported that the Government confirmed to the committee that they are currently drafting a CIT law which is expected to be presented to the legislative authority in March 2024.

We expect Bahrain to 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 (EUR 750 million) and follow the Global Minimum Tax (GMT) rate of 15% for businesses above that threshold. Given that Bahrain CIT is likely to apply to all commercial activities with limited exclusions, this will be a paradigm shift for Bahrain businesses.

Tax laws around the world typically contain specific provisions governing transactions between related parties. These are considered “special” transactions due to the link between the parties involved and the possibility that the agreed prices may not reflect market conditions. In other words, the existence of a relationship between the two parties creates a presumption that the price or value at which the transaction is conducted may result in a tax advantage for one or more parties.



With the potential introduction of CIT in Bahrain, it is expected that specific transfer pricing rules will apply to prevent related entities from shifting profits for gaining an undue tax advantage.

Transfer pricing rules

Transfer pricing rules seek to ensure that transactions between related parties (also referred to as controlled transactions) are carried out at an arm's length basis as if the transaction was carried out between independent parties. Transfer pricing rules generally apply to transactions between related parties regardless of whether such transactions are domestic or cross-border. Most GCC countries (excluding Bahrain) currently have some kind of transfer pricing rules in place which are largely modeled on the Transfer Pricing Guidelines issued by the Organization for Economic Co-operation and Development (OECD).

Related parties

Related parties of a company refer to any other companies in which the company (alone or together with another related party), has a controlling ownership interest (typically 50% or more of shares of the company), or entities that have greater than 50% common ownership. For natural persons, related parties refer to the natural person's relatives as well as companies in which the natural person (alone or together with another related party) has a controlling ownership interest (typically 50% or more of shares of the company).

Arm's length principle

Arm's length transaction is an expression commonly used to refer to transactions between two or more unrelated parties acting independently and in their self-interest. When independent parties transact with each other, the conditions of their financial and commercial arrangements are ordinarily determined by market forces. When the pricing of transactions between two related parties does not reflect market conditions and the arm's length principle, the profit and consequently the taxable income of the two parties may be distorted. The arm's length price is the price at which a willing buyer and a willing unrelated seller would freely agree to transact. As described in the Illustration, simplistically, the arm's length price for supply of goods by ABC Group Bahrain Co. should be BHD 7/- per unit since it is the transaction value agreed between two unrelated parties acting independently and in their self-interest.

Determining arm's length price

The OECD Transfer Pricing Guidelines prescribes the following methods to determine the arm's length price of a related party transaction or a controlled transaction.

1. **Comparable uncontrolled price method** – This method compares the price charged for a controlled transaction to the price of a comparable uncontrolled transaction in similar circumstances. Presence of a difference between the two prices may indicate that the transaction between the related parties is not at arm's length and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.
2. **Resale price method** – Under this method, computation of the arm's length price begins with the price at which a product that has been purchased from a related party is resold to an independent party. This price is then reduced by an appropriate gross margin that the reseller would typically seek based on the functions performed and market conditions. The amount arrived at after subtracting the gross margin may be regarded as the arm's length price of the original transaction.
3. **Cost-plus method** – Under this method, computation of the arm's length price begins with costs incurred by the supplier for carrying out the controlled transaction. An appropriate mark-up is added to this cost to reflect the functions performed and the market conditions. The price arrived at after the mark-up to the cost may be regarded as the arm's length price.
4. **Transactional profit methods** – These methods examine the profits that arise from specific transactions between related persons. Profits arising from a controlled transaction can be a relevant indicator of whether the transaction has been affected by conditions that differ from those that would have been made by independent parties in comparable circumstances.

Documentation requirements

The OECD Transfer Pricing Guidelines, which are followed by many jurisdictions, prescribe the following three-tiered structure for maintaining transfer pricing documentation:

- Local file: The local file contains the details of an entity or related entities in one jurisdiction. This type of documentation includes more than just the benchmarking information. The documentation in some cases needs to be filed directly to the local tax authority.
- Master file: The master file contains information on the group as opposed to a local file which provides information about one or more local entities in a specific jurisdiction. The Master file has more generic and high-level information whereas a local file is more detailed.
- Country-by-Country Report (CbCR): The CbCR is usually reserved for multinationals with a significant annual turnover (in Bahrain, the threshold is BHD 342 million). The multinational group can choose the country in which it has operations to file the report and file a notification (if applicable) in other jurisdictions. This documentation may be shared among tax authorities from different jurisdictions where there is an agreement in place between the two jurisdictions to exchange this information.

Impact of not complying with transfer pricing rules

Where the tax authority has concluded that the related party transactions have not been carried out at arm's length, they can make transfer pricing adjustments at the time of reassessing the taxable income. Transfer pricing adjustments involve correcting or aligning the transaction value for transactions between related entities with the arm's length value. These adjustments made by the tax authority may lead to imposition of penalties by the tax authorities due to change in taxable income.

Whilst the date of CIT implementation in Bahrain has not yet been announced, our publications are intended to provide Bahrain businesses with insights on leading practice. Businesses that act proactively will be better prepared to deal with the challenges of the rapidly evolving tax landscape.

For a detailed discussion on how the above may impact your business, [contact us](#).



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