Bahrain Tax Alert

Introduction of Domestic Minimum Top-Up Tax (DMTT)

3 September 2024

On 1 September 2024, the regional tax landscape has shifted yet again with the release of Decree-Law No. (11) of 2024 (DMTT Law) Regarding the Implementation of Tax on Multinational Enterprises (MNEs) located in Bahrain. Bahrain is the first GCC country to implement a DMTT aligned with the Organization for Economic Cooperation and Development (OECD) Base Erosion Profit Shifting (BEPS) Pillar Two Inclusive Framework. The DMTT Law applies the global minimum tax of 15% on Bahrain Constituent Entities (CEs) of MNEs and contains key operative provisions of the OECD Pillar Two Global Anti-Base Erosion Model Rules (GloBE rules). In essence, Bahrain's DMTT is a GloBE rules compliant domestic corporate income tax (CIT) applicable only to large MNEs.

The executive regulations and decisions (Regulations) for the implementation and enforcement of the DMTT Law will be released subsequently after Cabinet approval. The Regulations will prescribe detailed rules, conditions and procedures for implementing the DMTT Law in a manner consistent with the GloBE rules, guidance and commentary issued by the OECD. We have outlined below certain key features of the DMTT Law.

Key aspect	Details
Scope	MNE groups having total consolidated global annual revenues exceeding EUR 750 million (approx. BHD 312 million at the current FX rate) in at least two of the last four fiscal years will be in scope. An MNE group is a group that consists of entities located in more than one jurisdiction (subsidiaries, branches, joint ventures or other forms of presence). Standalone entities will be considered an MNE group if they have at least one permanent establishment in another jurisdiction.
Applicability	Fiscal years starting on or after 1 January 2025. Fiscal year is the accounting period used by the Ultimate Parent Entity (UPE) of the MNE Group.
Key definitions	Definition of key terms such as Constituent Entity, Ultimate Parent Entity, Permanent Establishment and Multinational Enterprise Group has been provided. The definitions are aligned with the GloBE rules.
Excluded entities	Excluded entities include government bodies, international organizations and investment funds/real estate investment vehicles that are UPEs. Excluded entities may still be required to register and are relevant in determining whether an MNE group exceeds the EUR 750 million threshold.
Calculation of Tax Due	Specific rules prescribed for calculation of Effective Tax Rate (ETR), Top-Up Tax, Taxable Income and Tax Due. The prescribed rules are aligned with the GloBE rules. There is no specific mention of the income inclusion rule (IIR) or the under tax payments rule (UTPR).
Registration, return filing and tax payment	MNEs will need to designate a Filing CE in Bahrain which will be responsible for registering with the National Bureau for Revenue (NBR), filing of annual tax returns, payment of the tax due, making elections and other tax administration matters. Advance tax payments will be required. Due dates and procedures for registration, return filing and tax payments will be prescribed in the Regulations.
De Minimis Exclusion	The Filing CE may elect to apply the De Minimis Exclusion if the following conditions are met: • Average CE revenue of all Bahrain CEs is below EUR 10 million; and • Average CE income of all Bahrain CEs is below EUR 1 million.
Accounting standards	International Financial Reporting Standards (IFRS) and any other financial accounting standards permitted by a local authorized accounting body as specified under the Regulations.

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Exclusion for initial international activity	Limited period relief available to Bahrain CEs of MNE Groups which meet the following conditions: • MNE Group does not have CEs in more than six jurisdictions; • Total net book value of assets of all CEs in jurisdictions, other than the jurisdiction which has the highest net book value of assets, does not exceed EUR 50 million; and • Bahrain CEs are not held by a parent in a jurisdiction which applies the IIR. Whilst this provision effectively turns off the Bahrain DMTT if the first two conditions are met, the IIR can still apply to a MNE Group in the initial phase of international activity if a parent entity is located in a jurisdiction that applies the IIR. To negate this, Bahrain has the third condition above and therefore restricted the relief to limited cases.
Safe harbor rules	Country-by-Country Reporting (CbCR) based transitional safe harbor available to MNE Groups which meet specified conditions for a limited period. Simplified computation safe harbor available for Bahrain CEs of MNE Groups subject to meeting specified conditions which is a welcome inclusion. The simplified computation safe harbour will permit the MNE to rely on simplified income, revenue and tax calculations in determining whether it meets the de minimis, routine profits or ETR test under the GloBE rules. Further guidance is expected in the Regulations.
General anti abuse rules	Any transactions or arrangements carried out without a genuine commercial purpose and with the primary purpose of obtaining a tax advantage may be disregarded.
Transitional provisions	Transitional rules prescribed for consideration of deferred tax assets/liabilities for calculation of ETR and valuation of assets transferred between CEs of the same MNE Group.
Statute of limitation & record keeping	Limitation period of 5 years from the date of payment of tax prescribed. This period may be interrupted in specified circumstances. Relevant records may be retained in either paper or electronic format. The type of records, controls and period of retention will be prescribed in the Regulations.
Penalties	Strict administrative penalties including: • Penalty of up to BHD 100,000 for offenses such as failure to register within prescribed time • Penalty of 1% per month of the unpaid tax amount for late payment • Penalty of up to BHD 50,000 for offences such as failure to update registration data, maintain prescribed records Violations which qualify as tax evasion offences may lead to imprisonment of up to 5 years in addition to fines of up to 3 times the amount of tax due.
Notable omissions	• There is no exclusion for defined shipping income similar to that provided in the GloBE Rules. • No mention of any Qualified Refundable Tax Credits in line with the GloBE Rules to attract investments. • No mention of a transitional penalty relief regime which recognises that no penalties or sanctions should apply during a specified transitional period in connection with filing GloBE Information Returns where an MNE has taken “reasonable measures” to ensure the correct application of the GloBE Rules. These may potentially be covered in the Regulations.

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Calculation of DMTT

Once it is confirmed that the entity falls within the scope of the DMTT Law, you will need to evaluate if any of the exclusions or safe harbour rules apply. If these do not apply, the next step is to calculate the ETR.

$$\text{ETR for Bahrain CEs} = \frac{\text{Adjusted Covered Taxes for CEs in Bahrain}}{\text{Net GloBE income for CEs in Bahrain}}$$

Adjusted Covered Taxes: The starting point is the current tax expense reported in the financial statements. Covered taxes include taxes on distributed profits, taxes imposed in lieu of a generally applicable CIT and taxes levied on retained earnings. Typical adjustments include any amount of covered taxes that are accrued as an expense in the profit before taxation of the financial accounts, amounts that reduce the effects of temporary differences, taxes paid in relation to an uncertain tax position and taxes on excluded dividends and capital gains.

Net GloBE income is the Financial Accounting Net Income or Loss (FANIL) as calculated under IFRS (or other acceptable accounting standard for example AAIOFI standards) before making any consolidation adjustments for elimination of intra group transactions and then subjected to other typical adjustments such as excluded dividends and capital gains, pension expenses, stock-based compensation.

Further details on the adjustments are expected to be included in the Regulations.

Once the ETR is calculated, the next step is to calculate the Top-Up Tax rate. Where the ETR is less than the minimum rate of 15%, the Top-Up Tax rate is calculated as follows:

$$\text{Top-Up Tax rate *} = \text{Minimum tax rate (15\%)} - \text{ETR (as calculated above)}$$

**We expect that for Bahrain CEs the Top-Up Tax rate will be close to 15%.*

The Top-Up Tax rate will be applied on the Taxable Income for calculation of the Tax Due. The Taxable Income will be calculated as follows:

$$\text{Taxable Income} = \text{Net GloBE income for CEs in Bahrain (see above)} - \text{Substance Based Income Exclusion (SBIE)}$$

The SBIE is calculated as the sum of a portion of the eligible payroll cost (starting from 9.6% tapering down to 5%) and tangible asset carrying value (starting from 7.6% tapering down to 5%) for each CE. Further details on computation of SBIE are expected to be included in the Regulations.

The Tax Due will be calculated based on the following formula:

$$\text{Total Tax Due} = (\text{Top-Up Tax rate} \times \text{Taxable Income}) + \text{Additional top up tax}$$

Additional top-up tax includes top-up tax arising due to adjustments to covered taxes or change in ETR due to recalculation of FANIL for a prior year and additional tax for any permanent differences which will be payable subject meeting certain conditions. This is an administrative relief in line with the GloBE Rules to prevent revising prior year returns.

The rules prescribed under the DMTT Law are complex and will have a direct impact on MNE Groups operating in Bahrain. With less than 4 months to implement, it is advisable for MNE Groups to assess the impact on their Bahrain operations for a smooth transition.

For a detailed discussion, contact us.

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