

## Bahrain Tax Alert

# FAQs on the Domestic Minimum Top-Up Tax (DMTT)

2 October 2024

On 1 September 2024, Decree-Law No. (11) of 2024 (DMTT Law) Regarding the Implementation of Tax on Multinational Enterprises located in Bahrain was released. The DMTT Law applies the global minimum tax (GMT) of 15% on Bahrain Constituent Entities (CE) of Multinational Enterprise (MNE) Groups and contains key operative provisions of the Organization for Economic Cooperation and Development's (OECD) Pillar Two Global Anti-Base Erosion Model Rules (GloBE rules). Bahrain is the first GCC country to implement a DMTT aligned with the OECD Base Erosion Profit Shifting (BEPS) Pillar Two Inclusive Framework (IF).

The executive regulations and decisions (Regulations) for the implementation and enforcement of the DMTT Law are yet to be released. The Regulations will prescribe detailed rules, conditions and procedures for implementing the DMTT Law.

Following our previous [Tax Alert](#) on the introduction of the Bahrain DMTT Law, we have outlined below certain Frequently Asked Questions (FAQs) in relation to the Bahrain DMTT Law.

### 1. Definitions

#### MNE group

A group is a collection of entities related through ownership or control such that the assets, liabilities, income, expenses and cash flow of such entities are included in the Consolidated Financial Statements of the Ultimate Parent Entity (UPE).

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 a multinational group if they have at least one permanent establishment (PE) in another jurisdiction.

#### UPE

A UPE is an entity that owns, directly or indirectly, a controlling interest in any other entity. In the case of a standalone entity with only PE(s) in another jurisdiction(s), the main entity will be the UPE.

#### CE

A CE is an entity within a group or a PE of a main entity that is part of a group.

#### PE

As per the Bahrain DMTT rules, a PE is:

- A place of business (including a deemed place of business) in a jurisdiction which is treated as a PE in accordance with an applicable tax treaty and such jurisdiction taxes the income attributable to such PE.
- If there is no applicable tax treaty, a place of business (including a deemed place of business) which a jurisdiction applies tax on the income attributable to such place of business on a net basis in a manner similar to how it applies tax on tax residents in such jurisdiction.
- If a jurisdiction has no corporate income tax system, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a PE, that such jurisdiction would have had the right to tax the income attributable to it.
- A place of business (or a deemed place of business) that is not already described above, through which operations are conducted outside the jurisdiction where the entity is located provided that such jurisdiction exempts the income attributable to such operations.

A PE that is considered a CE is treated as a separate entity from the main entity and its other PE(s). In essence, a PE can arise even where no legal presence exists.

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### **2. Does Bahrain currently have a broad-based CIT?**

Currently (September 2024), Bahrain does not have a broad-based corporate tax. It has a limited corporate tax at 46% that only applies to entities engaged in the exploration, production or refining of hydrocarbons in Bahrain.

From 1 January 2025 Bahrain will apply a DMTT to Bahrain CEs of large MNE groups having total consolidated global annual revenues exceeding EUR 750 million.

Whilst Bahrain currently does not have a broad-based CIT and no formal announcement has been made in this regard, we expect Bahrain (possibly within the next 18 months to 2 years) to also implement a broad-based CIT like other jurisdictions that applies to most businesses (with a potential carve out for small businesses in the initial years similar to the UAE and exclusion for entities engaged in the exploration, production or refining of hydrocarbons).

### **3. What is the DMTT and who does it apply to?**

Bahrain's DMTT, in essence, is a GloBE rules compliant domestic corporate income tax (CIT) that only applies to entities that are part of large MNE groups. The DMTT is applied on in-scope entities located in the relevant jurisdiction to bring the domestic tax liability of the in-scope entities to the GMT of 15% for a fiscal year.

The DMTT applies to Bahrain CEs of 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.

### **4. Why is the DMTT being introduced in Bahrain?**

Bahrain is one of the 147 countries (including Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) that have signed up to the IF on BEPS which outlines the key terms for an agreement for a Two-Pillar approach to international tax reforms.

Whilst Pillar One is focused on nexus and profit allocation (with wider transfer pricing and value creation related concepts), Pillar Two (also referred to as the GloBE proposal) is focused on a GMT for large multinationals, intended to address remaining BEPS issues.

Bahrain is implementing the DMTT to ensure that large multinationals operating in Bahrain are taxed at the GMT rate of 15% in line with the Pillar Two rules and such tax revenue is collected by Bahrain.

Had Bahrain not implemented the DMTT, profits generated by Bahrain Constituent Entities of large MNE groups in Bahrain could be subject to tax in other jurisdictions and Bahrain would concede the tax revenue that may have been generated from Bahrain sourced profits to another jurisdiction.

### **5. What are some other jurisdictions that have legislated Pillar Two/GLoBE rules already?**

Jurisdictions which have legislated Pillar Two/GLoBE rules already include Australia, United Kingdom, Canada, France, Germany, Japan, Luxembourg, Malaysia, New Zealand and Zimbabwe.

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### 6. *What is the effective date for applicability of the DMTT in Bahrain?*

Bahrain DMTT is applicable for fiscal years starting on or after 1 January 2025. Fiscal year is the accounting period used by the UPE of the MNE group.

For example, for a UPE that follows a fiscal year of 1 January to 31 December, the first year its Bahrain CEs will be subject to the DMTT is the fiscal year ending 31 December 2025.

### 7. *What will happen if Bahrain introduces a broad-based CIT later?*

Currently, the top up tax for Bahrain CEs of an in-scope MNE group will be close to 15% as there is no broad-based CIT due to which the current ETR would be close to 0%. However, if Bahrain introduces a broad-based CIT:

- Large MNE groups would need to first compute their tax liability under the broad-based CIT legislation and subsequently compute the top-up tax as per the DMTT rules.
- Other businesses would need to compute their tax liability only under the broad-based CIT.

### 8. *What is a Filing CE?*

Bahrain CEs of an in-scope MNE group will be required to appoint a Filing CE, who will be responsible for paying tax liabilities and handling all tax administration matters. A joint venture and its joint venture subsidiaries are also required to appoint a Filing CE.

### 9. *What are Joint Ventures and Joint Venture subsidiaries?*

Joint Venture is an entity whose financial results are reported using the equity method in the Consolidated Financial Statements of the UPE and the UPE holds, either directly or indirectly, at least 50% of its ownership interests.

A Joint Venture Subsidiary is an entity whose assets, liabilities, income, expenses and cash flows are consolidated by a Joint Venture.

Top up tax will be computed for Joint Ventures and Joint Venture subsidiaries as if they were CEs of a separate MNE group and the Joint Venture is the UPE of that group.

### 10. *Which entities are excluded for the DMTT purposes?*

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.

### 11. *How does the DMTT interact with the double tax treaties Bahrain has entered into?*

The Bahrain DMTT Law refers to the applicable tax treaty for the classification of a PE and the resulting taxing rights.

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### **12. What is the De Minimis Exclusion?**

The tax liability for a Filing CE for a fiscal year will be equal to zero, where the Filing CE elects to apply the De Minimis Exclusion if the following conditions are met:

- Average CE revenue of all Bahrain CEs for current and two preceding fiscal years is below EUR 10 million; and
- Average CE income of all Bahrain CEs for current and two preceding fiscal years is below EUR 1 million.

The policy rationale for a De Minimis exclusion is to avoid the complexities of a full top up tax computation where the amount of top up tax would not justify the associated compliance and administrative costs.

### **13. What are Safe Harbors?**

The implementation of the GloBE rules/Bahrain DMTT is expected to impose a disproportionate compliance burden on certain MNE groups especially in the initial years of implementation. To mitigate such issues, the Bahrain DMTT Law provides the following safe harbors:

- Transitional Country-by-Country Reporting (CbCR) based safe harbor available for a limited period to MNE groups which meet specified conditions.
- Simplified computation safe harbor allows the MNE group to rely on simplified income, revenue and tax calculations in determining whether it meets the de minimis, routine profits or effective tax rate test under the GloBE rules.

### **14. What are anti-abuse rules?**

The Bahrain DMTT Law contains general anti abuse rules which provide that any transactions or arrangements carried out without a genuine commercial purpose and with the primary purpose of obtaining a tax advantage may be disregarded. In essence, you cannot undertake a transaction or restructure if the dominant purpose is to obtain a tax advantage – you need to have genuine commercial reasons for undertaking the transaction or restructure.

### **15. Will Bahrain branches/subsidiaries of large foreign MNE groups be subject to the DMTT?**

As the DMTT applies to Bahrain CEs of MNE Groups, Bahrain subsidiaries and branches of such MNE groups which exceed the consolidated revenue threshold test will be impacted.

### **16. Will the income of foreign branches of a large Bahrain headquartered MNE groups be subject to the DMTT in Bahrain?**

The income of a foreign branches of Bahrain headquartered MNE groups will not be subject to DMTT in Bahrain as the DMTT Law seeks to apply a top up tax only on the taxable income of the CEs located in Bahrain.

### **17. What standards must be used to prepare financial statements?**

Financial statements must be prepared as per International Financial Reporting Standards (IFRS) or any other financial accounting standards permitted by a local authorized accounting body.

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### 18. How is the DMTT calculated?

Specific rules are prescribed for calculation of effective tax rate (ETR), top-up tax, taxable income and tax due.

- Once it is confirmed that the entity falls within the scope of the DMTT Law, CEs will need to evaluate if any of the exclusions or safe harbor rules apply.
- If neither the exclusions or safe harbor rules do not apply, the next step is to calculate the ETR for the Bahrain CEs.
- ETR is calculated using the Adjusted Covered Taxes for the CEs and the Net GloBE income for the CEs.
- 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 by reducing the ETR from the minimum tax rate of 15%.
- The top-up tax rate will be applied on the taxable income for calculation of the tax due.
- Taxable income is calculated by reducing Substance Based Income Exclusion from the Net GloBE income for the CE.
- The total tax due is then calculated by multiplying the top-up tax payable on the taxable income and any additional top up tax (arising due to adjustments).

We expect that for Bahrain CEs the top-up tax rate will be close to 15%.

### 19. What is Substance Based Income Exclusion (SBIE)?

The top-up tax is computed after applying a “substance-based income exclusion” which uses payroll and tangible assets as indicators of substantive activities in Bahrain. The policy rationale is to exclude a fixed return from the substantive activities that an MNE group undertakes within Bahrain.

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.

### 20. Will transfer pricing rules apply under the DMTT?

Whilst the Bahrain DMTT Law does not mention any specific transfer pricing rules, in line with the GloBE rules, the Regulations are likely to have an arm’s length requirement for cross-border transactions between CEs of the same MNE group.

There may be a requirement to make transfer pricing adjustments to the Financial Accounting Net Income or Loss of CEs that are parties to a controlled transaction where the transfer price used in the financial accounts does not reflect arm’s length.

The rules prescribed under the DMTT Law are complex and will have a direct impact on MNE groups operating in Bahrain. With less than 3 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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