



Domestic Minimum Top Up Tax on Multinational Enterprises

Kingdom of Bahrain

Bahrain announces Domestic minimum top up tax (DMTT) on Multinational enterprise (MNE) groups in accordance with OECD guidelines

To limit the risk of tax avoidance through shifting of profits to nil / low tax jurisdictions by multinational companies, 15 action plans were launched in 2013 under the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) 1.0 project, introducing coherence in the domestic tax rules, reinforcing substance requirements and improving transparency & certainty. While the above developments were implemented, there still existed the risk of profits to be shifted to such jurisdictions considering the mobile business models and heavy reliance on intellectual properties. To facilitate and monitor the implementation of BEPS 1.0 and to put an end to such shifting to profits, a forum called an Inclusive Framework (IF) was created, to secure a level playing field for all countries.

In May 2018, Bahrain had signed the IF and agreed to provide for a framework for global tax reform, which would need to be implemented in the form of a global minimum tax of 15%. It is important to note that Bahrain has already introduced the Country-by-Country Reporting [BEPS Action Plan 13] and the Economic Substance regime [BEPS Action Plan 5].

The IF members had further agreed to a two-pillar solution (BEPS 2.0 project) to address the tax challenges emanating from the constant digitalisation of the economies. Pillar 1 talks about a revised profit allocation and nexus-based approach and consists of an Amount A with a threshold of revenue of the MNE at USD 20 billion with a PBT at 10%, and an Amount B which provides for tax certainty through safe harbours for routine marketing and distribution entities by remunerating them with a fixed agreed return.

Pillar 2 addressing the Global minimum tax mechanism introduced the **Global anti-Base Erosion (GloBE) rules** whereby a minimum tax of 15% is collected in each jurisdiction, in which an MNE group with annual consolidated revenue over EUR 750 million functions, and by implementing the **Subject to tax rules (STTR)** into the bilateral tax treaties, to avoid treaty abuse.

The GloBE rules require that in order that such MNE groups achieve the above minimum tax level introduced a 3-pronged approach for the collection of the same:

- **Domestic minimum top-up tax (DMTT)** which provides a right to the nil / low tax jurisdiction itself to collect the minimum tax by implementing it in its domestic laws in accordance with the GloBE rules
- In case such DMTT is not introduced, the GloBE rules require the minimum / top-up tax to be collected through an **Income Inclusion Rule (IIR)** which requires the Ultimate parent entity (UPE) of the MNE group to pay the top-up tax, to the extent of its ownership interest, with respect to overseas group entities (i.e. subsidiaries and permanent establishments) in low tax jurisdictions
- **Under-taxed payments rule (UTPR)** which is a backstop to the IIR i.e., in a situation where none of the jurisdictions of parent entities (ultimate or intermediate) adopt and implement GloBE rules and the top-up tax cannot be recovered through even the IIR.

The questions that were being debated therefore centred around the consequences that Bahrain might face in the absence of a relevant tax regime (DMTT), which would lead to an UPE located in Bahrain to pay a top up tax in another jurisdiction on the profits generated in that country, besides an UPE, in a jurisdiction that has already implemented the IIR, paying the top up tax for low taxed subsidiaries in Bahrain.

Bahrain has now introduced the DMTT.

Action by Bahrain and launch of DMTT

In order to address the above, Bahrain is in the process of enforcing the Decree-Law No. (11) of 2024 regarding the Implementation of tax on Multinational enterprises (Law) in the form of a Domestic top-up tax on **Entities of Multinational enterprise (MNE) groups located in Bahrain, if the annual revenue of the MNE group equals or exceeds EUR 750 million in the consolidated financial statements of the UPE for at least two of the four fiscal years immediately preceding that fiscal year [revenue test]**, in consistency with the GLoBE rules. The minimum rate of tax prescribed is 15% and the tax is effective 1 January 2025. An unofficial translation of the Law has already been uploaded to the web site of the NBR. Further, regulations for enforcing the provisions of the Law, consistent with the guidelines and rules issued by the OECD, would be further issued.

The salient features of the law are as follows:

Imposition of DMTT: The DMTT shall be imposed on the taxable income for the fiscal year of the Constituent Entity (CE) in Bahrain which is a member of an MNE group that meets the above revenue test and would be payable by a filing CE on behalf of the CE. A CE is an entity within a MNE group or a permanent establishment of a main entity that is part of a MNE Group.

For the purposes of application of the Law, an entity that is a legal person would be considered as a tax resident of Bahrain if it is incorporated or established in accordance with the laws of Bahrain or if it has a place of effective management in Bahrain having been established under the laws applicable in a foreign jurisdiction.

Excluded entities: The law has also provided a list of excluded entities *inter-alia* Government bodies, international organisations, non-profit

organisations, pension funds, investment funds (being the UPE), real estate investment vehicles (being an UPE) etc. It is important to note though that the revenue of the excluded entities would be taken into consideration for the purposes of the determination of the revenue test.

The Law has also laid down steps for the computation of the DMTT and is based on formulaic approaches as follows:

Computation of the effective tax rate (ETR): ETR of the CE located in Bahrain and members of the same MNE group would be determined as **Adjusted covered taxes for the CEs in Bahrain divided by the Net CE income** (both adjusted covered taxes and CE income / loss of Investment entities excluded) where Adjusted covered taxes would be equal to current tax expense for the fiscal year as accrued in the financial accounting net Income or loss considered as covered taxes as laid down under the executive regulations to be introduced and the Net CE income the positive figure of the aggregate incomes and aggregate losses of all CE located in Bahrain. The financial accounting net income or loss shall be the Net CE income or loss before making any consolidation adjustments aimed at eliminating intra-group transactions

Computation of tax and de-minimis exclusions: Where the ETR as above is below the minimum prescribed rate of 15% for the fiscal year, there would be an additional tax on the CE to the extent of the difference between the **Minimum rate and the ETR**. Further, the taxable Income for the CE located in Bahrain would need to be calculated as the Net CE income as reduced by substance-based Income exclusions per the Law. The tax due would then be calculated as the **Additional tax rate as calculated above multiplied by the adjusted taxable Income**.

The law has also provided that the above would be needed to be increased by an **Additional current tax** i.e. the amount of tax for a fiscal year resulting from an adjustment in the covered taxes or re-computation of the ETR for a prior fiscal year and also by **Additional taxes for permanent differences**, in specific circumstances, for which a formulaic approach has also been suggested.

Substance-based exclusions: The substance-based exclusions provided by the Law is the sum of the payroll costs incurred by and the carrying values of certain tangible assets of the CEs in Bahrain.

De-minimis exclusions: The Law also provides for de-minimis exclusions and provides that taxes would be zero if the average (average of the current and 2 preceding fiscal years) constituent revenue of all CE in Bahrain, being members of the same MNE group, is lower than EUR 10 million and the average CE income or loss is lesser than EUR 1 million, provided the filing CE has notified the NBR of its annual election of such exclusions. Specific definitions of these terms have been provided under the Law.

CbCR safe harbour: The Law also provides that for any fiscal year beginning on or before 31 December 2026 but not including a fiscal year ending after 30 June 2028, the tax for the fiscal year would be deemed to be zero, if in such fiscal year, for the MNE group, the total revenue of the CEs located in Bahrain, amounts to less than EUR 10 million and the total profit or loss before income tax of such CEs is less than EUR 1 million, per the relevant CbCR reports filed, or the MNE Group's profit or loss before the taxes in Bahrain, per the CbCR reports for the concerned fiscal year, is equal to or less than the substance-based income exclusions. An alternative ETR based threshold and certain exclusions to this provision have also been prescribed.

Simplified computation safe harbour: The law has further prescribed a simplified computation of safe harbour wherein the tax for the CE in Bahrain would be zero if the CE income is less than the substance-based income exclusion or if the average annual revenue for all CEs located in Bahrain for the fiscal year and two preceding fiscal years, as determined by a simplified computation, is less than EUR 10 million and the average CE income of all such entities is less than EUR 1 million for the current and two preceding fiscal years, or if such entities have a net CE loss, or if the ETR of all CEs in Bahrain is at least at the minimum rate.

Exclusion for initial phases of international activities: The tax of the CEs located in Bahrain shall also be zero, if the MNE group has CEs located in no more than six jurisdictions and the sum of the net book value of tangible assets of all CEs located in all jurisdictions, other than the reference jurisdiction (i.e. the one in which the MNE group has the highest value of tangible assets at a time when the GloBE rules first applied to the group), does not exceed EUR 50 million and the ownership interests in the CEs located in Bahrain are not held by a parent entity which applies the IIR rule per the

guidelines issued by the OECD.

Tax registration: The filing CE would need to register with the NBR and the authorities may also, on the basis of information available with them, designate a filing CE including requiring any excluded entity to register for tax. The CEs in Bahrain of a MNE group that meets the revenue test or a joint venture and its subsidiaries would need to appoint one of them as the filing CE. The Law also provides for a 5-year election or an annual election by the filing CE.

Tax returns and amendments: The filing CE would need to submit a tax return for each fiscal years in the prescribed form and also file an amended tax return if the filing CE or a joint venture or a joint venture subsidiary finds an error in the return originally submitted. The filing CE would also inform the authorities if the MNE group does not satisfy the revenue test for a particular fiscal year and may choose not to file a tax return for the said year.

Tax payments, refunds, maintenance of records and tax audits: Taxes due would need to be paid to the NBR through advance payments during the fiscal year and one or more instalment payments during the fiscal year following the one in which the tax is due, in accordance with the regulations of the Law. A tax refund may also be claimed by the filing CE in case excess tax has been paid. Taxes would need to be paid in Bahraini Dinars, unless otherwise specified by the regulations. Specific processes would also be detailed in the regulations for the maintenance and verification of records including financial statements, accounting books, Invoices etc.

NBR may carry out tax audits to verify the accuracy of the tax return or to ensure compliance with the provisions of the Law.

The filing CE would need to assess the tax dues under the Law and the NBR may reassess, if it, based on facts and circumstances available with it, finds that the original tax return or the amended return contains an error. The NBR may also assess the tax if adequate information is not provided to support the tax return or if a filing CE does not submit a tax return within the deadline specified in the executive regulations.

Administrative fines: The NBR may levy administrative fines for failure to apply for registration within timelines mentioned or providing inaccurate details during registration etc., for failure to / delaying submissions of tax returns, for failure to pay tax or delaying tax payments beyond the prescribed period, submitting incorrect data in the tax returns etc. Specific range of such fines have been mentioned under the provisions of the Law, the CEs of the MNE group would be jointly liable for the payment of the taxes due and the fines imposed. Taxes due and administrative fines may be paid in instalments on request being made by the filing CE and approved by NBR.

Reviews, objections and appeals: Reviews / petitions may be made within 60 days of the communication of the unfavourable decision procedure by NBR. The review decision needs to be communicated by the NBR within 90 days. Objections to the tax objection committee can be made against such review decision within 60 days of such being communicated (or a further 60 days on payment of fee). Committee to issue its recommendation to the Minister within 90 days with the Minister approving, amending or revoking the recommendation within 30 days. Expiry of the above periods without communication will be deemed as implicit rejection.

The decision of the tax objections committee can be appealed against before the competent court within 60 days from the notification of the decision/ date of deemed rejection. An appeal does not negate the powers of the collection of taxes and administration fees, unless otherwise directed by the competent court.

Tax evasion offences: Failure to register, submit tax returns, incorrect data in the tax returns, alteration of data, understating profits and deflating losses, submission of incorrect data with an intention of not paying taxes, concealing / failing to disclose activities of the CEs subjected to

tax etc. would be deemed to be criminal offences with imprisonment and fines with the High Criminal Court having jurisdiction, Appealable to the High Criminal Court of Appeal.

GAAR: The Law also contains an article on General anti-avoidance rules, whereby the NBR may disregard any transaction / arrangement / series of arrangements, if in its opinion the primary purpose / one of the primary purposes of such transactions / part of it, is to obtain a tax advantage and also determine resultant tax liabilities.

Transitional provisions: DTA and DTL disclosed in the financial statements may be taken for the purposes of the computation of the ETR in the transition and any subsequent year with certain exclusions.

Way forward:

Bahrain, as a signatory to the IF clause and as a NIL corporate tax jurisdiction, was needed to bring forth the Law as have been promulgated. For the MNE groups, who pass the revenue test, it would be important to look into an initial impact assessment of the Law such that an approximate understanding of the tax liability is available. It would be also important to explore initial compliance mechanism, strategise group taxes, chart out group tax policies for the CEs and the Filing CE, revamping accounting systems to accommodate the data requirements, training of the tax team on the new requirements and built suitable ringfences from the perspective of tax exposures and penalties.

We are happy to schedule a discussion on how the Law may impact your businesses, share our learnings and experiences gathered from the implementation in other jurisdictions, discuss the way forward, and provide you with customised numerical models for you to understand the potential tax liabilities under the Law.

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