Bahrain Domestic Minimum Top-up Tax for Multinational Enterprises

Initial reactions and key takeaways

September 2024

Bahrain releases Domestic Minimum Top-Up Tax legislation

On 1 September 2024, Bahrain issued the Decree Law (11) of 2024 which introduces a Domestic Minimum Top-Up Tax ("DMTT") for Multinational Enterprises ("MNEs") (hereinafter referred to as the "DMTT Law"). The unofficial translation can be found on the National Bureau for Revenue ("NBR") website. FAQs were also published on the NBR website, and these provide a number of useful clarifications to the DMTT Law.

The DMTT Law provides the legislative basis for the introduction and implementation of a DMTT in Bahrain, and it is intended to be consistent with the OECD Global Anti-Base Erosion ("GloBE") Model Rules. The FAQs clarify that the DMTT Law is effective for financial years starting on or after 1 January 2025. Notably, the DMTT Law will only apply to MNEs with global consolidated revenues (in at least two of the preceding four fiscal years) of at least EUR 750 million. This includes MNEs headquartered in Bahrain, as well as any other MNEs (headquartered in other countries) with operations in Bahrain. The DMTT Law will not apply to local businesses with no operations outside Bahrain.

The DMTT law is a key development for MNEs in Bahrain. In addition to potential additional tax costs (on profits generated in Bahrain), it introduces new compliance requirements. It is important to note that the DMTT Law mainly lays out the framework of the rules (intended to be aligned with the GloBE Model Rules), however further details are expected in the executive regulations and decisions to the DMTT Law ("Regulations"), which will be released in due course upon approval by the Bahrain Cabinet. We have outlined below certain key features of the DMTT Law, including some of our initial reactions and key takeaways.

Key highlights

Overview of DMTT

The DMTT Law introduces a jurisdictional-level Top-up Tax aimed at large MNE Group, ensuring that the minimum effective tax rate ("ETR") of 15% is met. Under the DMTT Law, if the aggregated results of Bahraini Constituent Entities ("CE") of an MNE Group do not result in a 15% ETR, Bahrain will impose an additional tax to meet the 15% minimum ETR. It should be noted that the DMTT Law does not include an Income Inclusion Rule ("IIR") or an Undertaxed Payments Rule ("UTPR"), the other key charging mechanisms as prescribed by the GloBE Model Rules.

Scope of DMTT

The DMTT Law is expected to apply to CEs located in Bahrain of MNE Groups that meet the following criteria:

1. The MNE Group holds entities (including subsidiaries, branches or permanent establishments) located in at least one other jurisdiction to that of the ultimate parent of the group; and
2. The MNE Group has annual consolidated global revenues of at least EUR 750 million in at least two of the preceding four fiscal years.

Excluded Entities

The DMTT Law excludes the following entities ("Excluded Entities") from its application:

1. government bodies;
2. international organizations;
3. non-profit organizations;
4. pension funds;
5. investment fund that is an ultimate parent entity ("UPE");
6. real estate investment vehicle that is a UPE;
7. an entity, other than a pension service entity, subject to meeting certain conditions, e.g:
   a. if least 95% of its value is owned, directly or indirectly, by one of the aforementioned Excluded Entities, the entity operates exclusively or almost exclusively to own assets or invest funds for these Excluded Entities, and it only engages in activities ancillary to those performed by the Excluded Entities; or
   b. if least 85% of its value is owned, directly or indirectly, by one of the aforementioned Excluded Entities, and the entity's income is primarily derived from gains and losses on shares or equity interests that are excluded from the calculation of the Constituent Entities' ("CE's) income or loss.

Excluded Entities are not treated as CE of the MNE Group. However, the revenue of the above Excluded Entities will be considered in determining whether the revenue threshold of EUR 750 million or more is met by the MNE Group. Further, the NBR may still require the Excluded Entities to register for the DMTT. The DMTT Law contains an election not to treat an Excluded Entity for entities under this category.

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Calculation of the ETR

Constituent Entities: The ETR for CEs located in Bahrain will be determined on a jurisdictional level, i.e. taking into account all Bahrain CEs within the MNE Group.

$$\textbf{ETR} = \frac{\text{Adjusted Covered Taxes}}{\text{Net CE Income}}$$

For this purpose, **Adjusted Covered Taxes** is equal to the sum of all the Bahrain CEs' current tax expense as accrued in each of their financial statements for a fiscal year, and which are considered as Covered Taxes. The Regulations will outline the conditions that must be met for a tax to be treated as a Covered Tax, and this is expected to be in line with the GloBE Model Rules. Broadly, Covered Taxes include the income taxes recorded in the financial statements and taxes imposed in lieu of a generally applicable corporate income tax.

On the other hand, **Net CE Income** refers to the positive sum of the aggregated income and loss of all the CEs located in Bahrain. The CE income or loss is the financial accounting net income before making any consolidation adjustments to eliminate intra-group transactions in accordance with the local financial accounting standards of the CEs. The Regulations will outline the adjustments that are taken into account in the computation of Net CE Income, and these are expected to be in line with the GloBE Model Rules. For instance, some of the common adjustments include dividends and capital gains where certain conditions are met.

It is also important to note that the ETR for a Stateless CE will be calculated separately from that of other CEs, in line with the GloBE Model Rules.

Joint Ventures ("JVs"): Consistent with the GloBE Rules, JVs (entities that are held at least 50% directly or indirectly by the UPE and are equity accounted for by the UPE) are subject to the DMTT Law. However, the JVs and their consolidated subsidiaries and branches / permanent establishments, if any, must be treated as a separate MNE Group and their ETR will be computed separately from that of CEs (the same applies for the assessment of Safe Harbours).

The DMTT Law is silent on whether the ETR calculations will be performed on the basis of an MNE Group having a 100% ownership interest or proportionate ownership interest in the CEs or JVs. The expectation would be the former, i.e. the GloBE Model Rules provide that a Qualified DMTT ("QDMTT") should also be based on the whole amount of the jurisdictional Top-up Tax irrespective of the ownership interest held by the MNE UPE in the local CEs or JVs. Further details are expected in the Regulations.

Taxable Income and Substance-Based Income Exclusion

Consistent with the GloBE Rules, the Taxable Income is determined by subtracting the Substance-Based Income Exclusion ("SBIE") from the Net CE Income (see above) of all of the CEs in Bahrain. The SBIE is based on Payroll Costs (being a minimum of 5% and maximum of 9.6% of certain payroll costs) and Tangible Assets (being a minimum of 5% and maximum of 7.6% of the carrying value of certain tangible assets). Further details are expected in the Regulations, to ensure alignment with the GloBE Model Rules.

Calculation of Tax due under the DMTT Law

Tax due under the DMTT Law includes the following:

- **Additional Tax**: This is calculated by multiplying the Taxable Income and the difference between the 15% minimum rate and the ETR for all Bahrain CEs of the MNE Group.
- **Additional Current Tax:** This refers to any Tax amount resulting from a re-calculation of previous fiscal years' DMTT calculation as a result of a change in Covered Taxes or change in ETR due to recalculation of financial accounting net income or loss. This removes the requirement to re-file DMTT returns for previous fiscal years where the Tax amount calculated needs to be adjusted.
- **Additional Tax for Permanent Differences:** This is calculated as the absolute value of the aggregate Adjusted Covered Taxes less the absolute value of the Net CE Income multiplied by 15%. This tax is expected to apply only if certain conditions are met.

De Minimis Exclusion

The DMTT due is expected to be “nil” if the Filing CE notifies the NBR of an annual election to apply the De Minimis Exclusion. The conditions for this exclusion to apply are:

- Average CE revenue (for the current and two preceding fiscal years) of all the CEs in Bahrain of an MNE Group is less than EUR 10 million; and
- Average CE income or loss (for the current and two preceding fiscal years) of all the CEs in Bahrain of an MNE Group is a loss or less than EUR 1 million.

Safe Harbours

For fiscal years beginning on or before 31 December 2026, and excluding fiscal years ending after 30 June 2028, the DMTT includes the transitional Country-by-Country Reporting (“CbCR”) Safe Harbours where the tax due may be considered "nil" if any of the following simplified tests are met:

- **De minimis test:** total revenue (as shown on the CbCR) of CEs of an MNE Group located in Bahrain amounts to less than EUR 10 million and their total profit or loss before income tax (on the CbCR) amounts to less than EUR 1 million in the tested fiscal year.
- **Simplified ETR test:** an alternative ETR for the MNE Group in Bahrain is equal to, or greater than 16% and 17% for fiscal years beginning in 2025 and 2026, respectively.
- **Routine profits test:** total CbCR profit (loss) of the MNE Group in Bahrain is equal to, or less than the substance-based income exclusion amount determined under the DMTT Law (see above).

The transitional CbCR Safe Harbours will not be applied by: (i) a Stateless CE, (ii) a multi-parented MNE Group which does not report the information of the combined subgroups in a single CbCR (with the exception of their JVs), or (iii) a CE that has entered into a hybrid arbitrage arrangement after 15 December 2022.

Consistent with the Inclusive Framework’s Pillar Two Safe Harbour Guidance, we expect the transitional CbCR safe harbour relief under the DMTT Law to be available only where the MNE Group prepares its CbCR using Qualified Financial Statements. We also expect this transitional CbCR safe harbour regime to contain a "once out, always out" rule, i.e. once the transitional CbCR safe harbour is not applied for one fiscal year, it cannot be applied for subsequent years. Further details are expected in the Regulations.

In lieu of the transitional CbCR Safe Harbours above, the DMTT Law also provides an alternative Simplified Computation Safe Harbour (i.e. a permanent safe harbour) which incorporates similar tests, albeit under an alternative simplified income calculation methodology. Further details are expected in the Regulations, to ensure alignment with the GloBE Model Rules.

Other areas to note

Initial Phase of International Activity Exclusion

The DMTT will be reduced to nil, for a maximum period of 5 years, if the MNE Group meets the following conditions:

- CEs are located in no more than six jurisdictions; and
- The net book value of tangible assets across all jurisdictions does not exceed EUR 50 million, excluding the jurisdiction where the MNE Group has the highest value of tangible assets when the global minimum tax rules first apply to that MNE Group; and
- No ownership interests in the CEs are held by a parent applying the Income Inclusion Rule.

Accounting Standards

The DMTT Law prescribes the applicable accounting standard for in scope entities to be the International Financial Reporting Standards ("IFRS") and any other generally accepted accounting principles, to be specified in the Regulations.

Transitional Rules

The DMTT Law prescribes certain transitional rules around the tax basis of deferred tax assets / liabilities in relation to non-inventory asset transfers between CEs of the same MNE Group. Further detail around the operation of these rules will be specified in the Regulations.

Anti-Abuse Rules

The DMTT Law contains general anti-abuse rules to apply to transactions that would give rise to a tax advantage, where no valid commercial reason exists and where the tax advantage was the main or one of the main purposes of the transaction.

Administrative Matters

Where more than one CE are located in Bahrain, the MNE Group must designate a Filing CE.The same applies to JVs located in Bahrain. This entity will be responsible for paying the tax and managing all tax administration obligations, including registration, filing returns, making elections, and submitting notifications.

All CEs located in Bahrain of an MNE Group are jointly liable for the payment of tax and administrative fines due. The same rule will apply to a Bahraini JV and its Bahraini subsidiaries, if any. MNE Groups might need to consider an internal allocation methodology for the Top-up Tax among its CEs and JVs, taking into account the impact on non-wholly owned entities, potentially affecting investors outside the MNE Group.

The DMTT Law outlines procedures for registration, deregistration, tax return submission and amendments, currency, and additional record keeping requirements. Details on the information required in tax returns, filing deadlines, payment schedules, and record-keeping / retention will be specified in future Regulations.

The DMTT due for a fiscal year will be paid via advance payments during the relevant fiscal year and one or more installment payments during the following fiscal year. Further guidance is to be specified by the Regulations.

Penalty regime

The DMTT contains a strict penalty regime in cases of fraud or non-compliance. Penalties include the following:

- Failure to register or applying for registration using incorrect information: up to BHD 100,000
- Failure to comply with administrative and compliance requirements: up to BHD 50,000
- Late payment of tax: 1% of the unpaid tax per month (with a maximum total penalty of 70% of the total tax due)
- Late filing of the tax return: up to 30% of the tax due
- Tax evasion: criminal liability including imprisonment of between three months and five years, and/or monetary penalties between the monetary value of the tax due and up to three times the tax due; this is doubled where the offense is repeated within six years from the date of the issuance of the final conviction. "Tax evasion" includes among others, situations where an MNE Group intentionally does not register for the DMTT or fails to submit a DMTT return or provides incorrect information in its DMTT return.

Bahrain releases corporate tax legislation

Takeaway and next steps

The Bahrain DMTT Law is based on the GloBE Model Rules. It outlines the key aspects of the DMTT, with further details to be included in the Regulations. Below are some items on which we expect further clarity in the Regulations.

Issue	Comment
Application of DMTT based on ownership vs 100%	A QDMTT as contemplated by the GloBE Model Rules should apply on 100% of the jurisdictional Top-up Tax, regardless of the MNE Group's ownership interest in the CEs, and this approach should be adopted for Minority Owned Constituent Entities ("MOCEs") and JVs. To qualify as a QDMTT, the Bahrain DMTT would need to be applied on this basis. Where a DMTT is not considered as a QDMTT, the taxes paid under the regime should be considered as a Covered Tax (subject to meeting certain conditions), rather than a reduction / elimination of the jurisdictional Top-up Tax liability for IIR and UTPR purposes. This could lead to additional taxes being paid in another jurisdiction under IIR and UTPR in respect of Bahrain profits.
Treatment of Minority-Owned Constituent Entities ("MOCEs") for ETR calculation	The GloBE Model Rules provide a different treatment for MOCEs (i.e. entities where the UPE has a direct or indirect ownership interest of 30% or less), whereby their ETR and Top-up Tax is computed separately from other CEs. The same approach is required for a DMTT, in order to be considered a QDMTT. Consideration could also be given to whether the liability of MOCEs would be separated from that of an MNE Group's other CEs, given that MOCEs are majority owned by other shareholders outside the MNE Group.
Effective date of future amendments to the OECD Model Rules	The DMTT Law will come into force on 1 January 2025 and its supporting Regulations are expected to be issued in due course. It is understood that the DMTT Law is intended to be consistent with the GloBE Model Rules and their supporting Commentary and Administrative Guidance. Changes to these rules are expected to continue being issued by the OECD / Inclusive Framework over the medium term (beyond 2024). In this regard, it is currently not clear from the DMTT Law how any future amendments to the GloBE Model Rules, Commentary and Administrative Guidance will be transposed into the DMTT Law. More specifically if such changes would be prospective, immediate or retrospective. This will be key in providing certainty to taxpayers and ensuring seamless application of the DMTT Law by both the tax administration and taxpayers. As a general observation, a number of jurisdictions are considering adopting future changes to the GloBE Model Rules as and when they are released by the OECD, to the extent the domestic laws permit doing so.
Filing and payment deadlines	We anticipate that the timelines for the Bahrain DMTT filing and payments would align to the approach adopted by other jurisdictions (for instance granting taxpayers sufficient time in the first filing period) and to the timelines of other GloBE related filings (e.g. GloBE Information Return) that MNEs may need to undertake elsewhere.
Availability of transitional penalty relief measures	The GloBE Model Rules are inherently complex and this extends to DMTT rules. In addition, the DMTT is the first broad direct tax introduced in Bahrain. As such, we expect increased complexity, uncertainties and challenges for taxpayers in applying the rules in the initial periods. Having in place a transitional penalty relief regime that could be based on the GloBE Model Rules' 'Transitional Penalty Relief' may be of benefit to Bahrain taxpayers during the initial periods. A number of countries (including those in the EU) have put in place transitional penalty relief regimes.

Further to the above, Bahrain's DMTT will need to undergo the transitional qualification by the Inclusive Framework before it can be confirmed as a Qualified DMTT, with a peer review process within two years of the Decree coming into effect. A similar process will be required to confirm if the Qualified DMTT meets the standards for a QDMTT Safe Harbour. Subject to the details in the Regulations, our current reading of the DMTT Law indicates that it is meant to be both a Qualified DMTT and also meet the Safe Harbour criteria. However, the final position will be confirmed based on the Regulations and the outcome of the peer review process.

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Contact us

In the meantime, it is essential for multinational groups operating in Bahrain to plan ahead and get ready for the upcoming regime as it could have profound implications not only in the form of additional tax costs but also a significantly increased compliance burden. Given that the DMTT Law is intended to be in line with the OECD Model Rules, there should be a good basis for MNE groups to initiate an impact assessment to be supplemented if needed after the Regulations are issued.

Our team is working on impact assessments, readiness, and implementation support, such as systems and process updates for a variety of businesses in the region in the context of the Pillar Two rules including DMTTs, and will be happy to support you.

For further assistance, please contact us by emailing richard.b.bregonje@pwc.com, hanan.abboud@pwc.com, jochem.rossel@pwc.com, or mohamed.almahroos@pwc.com.

Stay tuned for our further updates soon.

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