Corporation Tax implications in Bahrain

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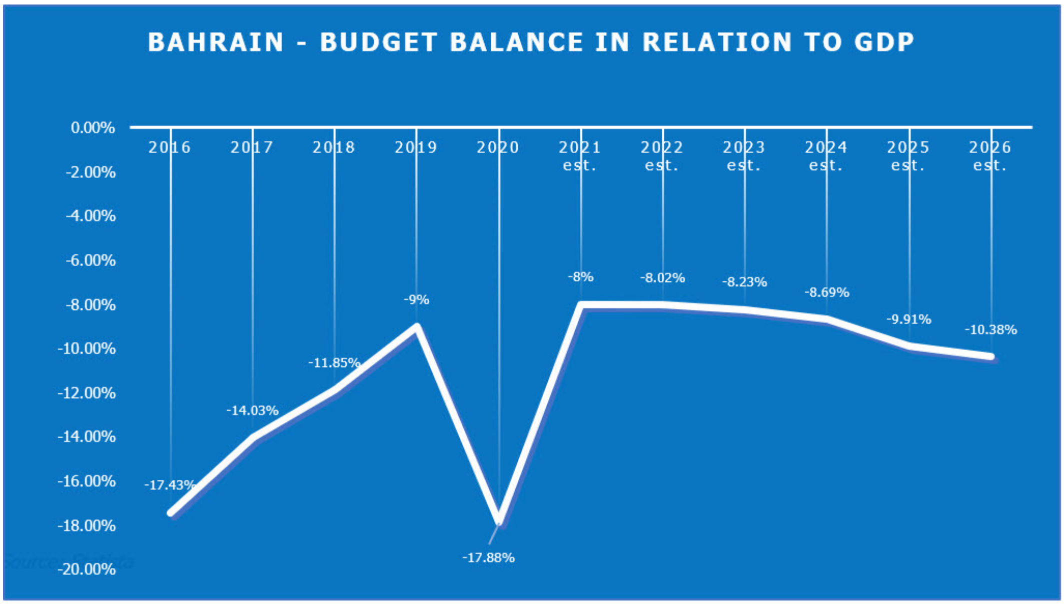
Analysis

Corporation tax is yet to be introduced in Bahrain. The Kingdom has so far, generated the bulk of its tax revenue from corporate taxes on oil and natural gas companies, allowing other industries to operate in a relatively low-tax environment. Therefore, Bahrain is at present the only country in the GCC which has not introduced corporation tax. Five out of the six GCC countries have corporation tax regimes. This is 10% in Qatar, 15% in Kuwait and Oman, 20% in Saudi Arabia and the newly proposed rate of 9% in the UAE. The Kingdom currently has a limited corporate tax of 46% that only applies to companies engaged in the exploration, production or refining of hydrocarbons.

Bahrain has been a member of the OECD's Base Erosion and Profit Shifting (BEPS) Inclusive Framework since 2018. Therefore, the Kingdom is committed to aligning national regulations and processes with the international tax framework and implementing the BEPS minimum standards.

In the context of Bahrain, VAT came into force in 2018 at the rate of 5%, with a 100% increase in the applied rate in 2021. Debt to GDP ratios were adversely impacted by the pandemic as can be seen in the chart below:



Source: Statista

Current developments

Therefore, in 2020, the Bahrain Parliament considered the introduction of corporation tax and this was discussed in Parliament [1]. Although the motion did not pass, it is still anticipated, corporation tax will be implemented in one to two years from 2022.

Bahrain has in the last few years implemented other regulations like Economic Substance, Ultimate Beneficial Owner and Country-by-Country reporting.

Regulations like these fundamentally target corporate structures which shift income or profits to entities in jurisdictions with nil or low tax regimes. In effect, the national vision is to demonstrate transparency and compliance with global regulatory goals in assessing risks related to transfer pricing and BEPS for multinational entities.

Possible implications in Bahrain

All multinational entities can expect their effective tax rates globally to change in the coming years as a result of 'Pillar Two' of BEPS and the impact on groups in the Middle East is expected to be greater given the prevailing nil/low tax environment. While the Economic Substance rules have been introduced in the UAE and Bahrain, Pillar Two proposals do not provide for any exemption where constituent entities in these countries are subject to local substance requirements. Therefore, in line with one of the key developments in the UAE, Bahrain could incorporate Pillar Two principles into their domestic tax framework and more importantly introduce corporation tax.

Therefore, there are multiple reasons why corporation tax will be implemented. These include the national fiscal deficit constraints, the potential national loss of tax, in other jurisdictions, when from 2023 the Global Minimum Tax (GMT) rules are implemented and compliance with international treaties.

Suggestions in view of corporation tax introduction

It is suggested that given the potential introduction of corporation tax, businesses in Bahrain consider an impact assessment in respect of:

- Possible adjustments to accounting profit to arrive at taxable income and calculation of tax liability.
- Potential revisions in their pricing strategy
- Potential impact on Shareholders
- Potential impact on employee remuneration and benefits

- Establishing appropriate internal controls to ensure that tax policy is properly embedded across the organization.

Due to its historical zero-tax environment, Bahraini businesses would need to understand that corporation tax applies to the adjusted taxable profits based on law which could differ from book profit due to differences between accrual-based reporting frameworks and taxation reporting requirements. In other words, in the Bahrain context, financials are prepared under International Financial Reporting Standards (IFRS) or standards set by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). Therefore, businesses must understand that these financials would require adjustments to arrive at the taxable profits as these invariably differ from the requirements of tax legislation. IFRS or AAOIFI standards follow an accrual basis, while tax authorities usually follow a cash basis (or timing differences in case of revenue and expense recognition) and there could be deductions for charitable contributions and differences in depreciation rates under taxation law.

A corporation tax law and related regulations, when implemented would provide a detailed understanding of the adjustments and exemptions available to arrive at the taxable profits.

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