



## Bahrain-Transfer Pricing Insights

### Introduction of Pillar 2- Implementation of Tax on MNEs

December 2024

**vstn** Consultancy  
Transfer Pricing Experts

#### Overview

As a member of the OECD Inclusive Framework since 2018, and a signatory to the Pillar 2 Solutions Statement in 2021, the Kingdom of Bahrain issued **Decree Law No.11 – Regarding implementation of tax on multinational enterprises** (“The Law”), on September 01, 2024, introducing the Domestic Minimum Top Up Tax for Multinational Enterprises (“MNE’s”). The Law shall come into force from **January 01, 2025** to In-Scope Constituent Entities within the Kingdom of Bahrain.

On December 11, 2024, The Ministry of Finance and National Economy, through Decision No.(172) of 2024 issued the executive regulation for the Law (“Regulation”). The Regulation introduces the arm’s length principle in Article 13 thereby bringing In –Scope Constituent Entities, within the ambit of transfer Pricing regulations.

The Law is in line with the OECD Globe Anti- Base Erosion Model Rules (“Globe Rules”).

#### Scope of Law

<b>Applicability</b>	In- Scope Constituent Entities are Constituent Entities of MNE groups whose:- <ul style="list-style-type: none"> <li>• Consolidated annual Revenue exceeds EUR 750 million in at least two of the four Fiscal Years immediately preceding that Fiscal Year</li> </ul>
<b>Effective Tax Rate</b>	<ul style="list-style-type: none"> <li>• A minimum effective tax rate of 15% shall be met by Bahraini Constituent Entities.</li> <li>• If the effective rate of the Constituent Entity is lower, then additional Tax may be imposed to ensure that the effective tax rate of 15% is met</li> </ul>
<b>Excluded Entities</b>	<ul style="list-style-type: none"> <li>• Government bodies;</li> <li>• International organizations;</li> <li>• Non-profit organizations;</li> <li>• Pension funds;</li> <li>• Investment fund that is an ultimate parent entity (“UPE”);</li> <li>• Real estate investment vehicle that is a UPE;</li> <li>• Entity, other than a pension service entity, subject to meeting certain conditions,</li> </ul>

Note: - For the purposes of determining whether the revenue threshold EUR 750 million is met, the revenues of excluded entities are also to be considered.

## Entity Location

- In case of a constituent entity is located in more than one jurisdiction then the jurisdictional location of the constituent entity shall be determined as follows:-
  - Where a tax treaty is in force between the jurisdictions, Constituent Entity shall be deemed to be in the jurisdiction where it is resident for the purposes of that Tax Treaty
  - However where there is no tax treaty in force or where the competent authorities have not reached a consensus as to the tax residency of the Constituent entity then the jurisdictional location of the constituent entity shall be determined as follows:-
    - The Constituent Entity shall be deemed as located in the jurisdiction where it paid more Covered Taxes for the Fiscal Year, without considering the taxes paid under Controlled Foreign Company Tax Regime
    - If the amount of Covered Taxes paid in both jurisdictions is the same or zero, the Constituent Entity shall be deemed as located in the jurisdiction where it has more Substance-based Income Exclusion computed on a standalone basis for the Fiscal Year.
    - If the amount of Substance-based Income Exclusion in both jurisdictions is the same or zero for the Fiscal Year, the Constituent Entity shall be considered a Stateless Constituent Entity unless the Constituent Entity is the Ultimate Parent Entity (UPE) of the MNE Group, in which case it shall be deemed as being located in the jurisdiction where it is created.



## Pillar 2- DMTT

### Effective Tax Rate (“ETR”)

- The ETR shall be computed for all Constituent Entities located in the Kingdom which are members of the same MNE Group.
- ETR is computed as follows:-

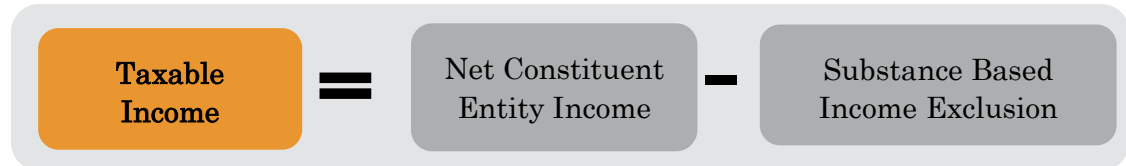
$$\text{ETR} = \frac{\text{Adjusted Covered taxes}}{\text{Net Constituent Entity Income}}$$

Where,

**Adjusted Covered Taxes** means current tax expense for that Fiscal Year of all Constituent Entities in the Kingdom, as accrued in its Financial Accounting Net Income or Loss considered as Covered Taxes as set out in the Regulations

**Net Constituent Entity Income** means the positive sum of the aggregate Income and the aggregate Loss, of all the Constituent Entities located in the Kingdom.

- **Additional Tax:**-Where the ETR computed above falls below the minimum tax rate (i.e. 15%), the difference between the ETR and minimum rate shall be regarded as additional tax rate that shall be applied on the taxable income to arrive at the additional tax amount.
- Taxable Income for the above purposes shall mean



- The substance based income exclusion shall be the sum of :-
  - Certain payroll costs incurred by Constituent Entity in the Kingdom (Starting from 9.6% in FY 2025 and gradually decreasing to 5% in FY 2033); **and**
  - Carrying value of certain tangible assets of Constituent Entities located in the Kingdom at the end of the Fiscal Year (Starting from 7.6% in FY 2025 and gradually decreasing to 5% in FY 2033)

### Computation of Tax Due

- The Tax due shall be the sum of:-
  - **Additional Tax:** As explained above (Differential tax between 15% minimum rate and the ETR for all Bahrain CEs of the MNE Group.
  - **Additional Current Tax:** This refers to any amount of Tax for a Fiscal Year resulting from an adjustment in Covered Taxes or the Constituent Entity Income or Loss as a result of the recomputation of the Effective Tax Rate for a prior Fiscal Year.
  - **Additional Tax for Permanent Differences:** This is calculated as the absolute value of the aggregate Adjusted Covered Taxes minus the absolute value of the Net CE Income multiplied by minimum rate i.e. 15%. This tax shall be applicable if certain conditions are met.

### De Minimus Exclusion

- Where the following two conditions are met, the tax for a filing constituent entity for a fiscal year shall be zero:-
  - The Average Constituent Entity Revenue of all Constituent Entities located in the Kingdom, which are members of the same Multinational Enterprise Group, is less than ten million Euro (EUR 10 million).
  - The Average Constituent Entity Income or Loss of all Constituent Entities located in the Kingdom, which are members of the same Multinational Enterprise Group, is a loss or income less than one million Euro (EUR 1 million).

## Transitional Country-by-Country Reporting (CbC) Safe Harbor

- For fiscal years beginning on or before 31 December 2026, but excluding fiscal years ending after 30 June 2028, the tax due may be considered "nil" if any of the following conditions are met:
  - If the De minimus criteria as above is satisfied,
  - 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.
  - Total CbC profit /(loss) of the MNE Group in Bahrain is equal to, or less than the substance-based income exclusion amount determined under the Law (as explained above).
- The above transitional provisions shall not apply to :
  - a Stateless CE,
  - a multi-parented MNE Group which does not report the information of the combined subgroups in a single CbC reporting (with the exception of their JVs), or
  - Constituent Entity that has entered into a hybrid arbitrage arrangement after 15 December 2022.



## Arm's Length Principle

### Introduction

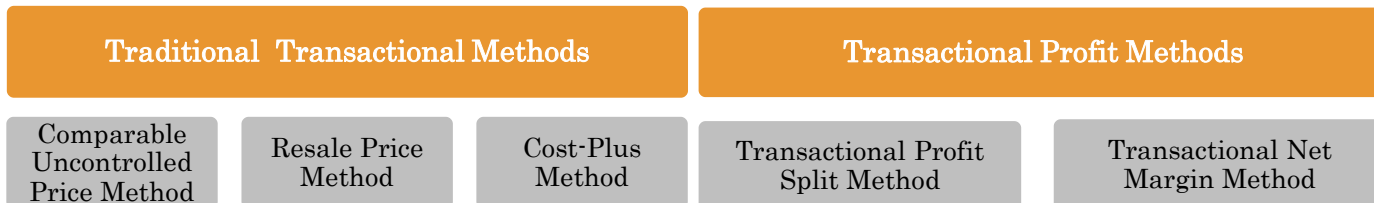
- In-Scope Constituent Entity located in the Kingdom i.e Constituent Entities which are part of the MNE Group meeting the revenue threshold of EUR 750 million in 2 out of 4 fiscal years preceding the current fiscal year, shall make necessary adjustments in determining its Constituent Entity Income or Loss to ensure that an outcome of a transaction or an arrangement with another Constituent Entity located in a different jurisdiction, which is a member of the same Multinational Enterprise Group, is consistent with the Arm's Length Principle.
- Arm's Length Principle refers to principle wherein the transactions between Constituent Entities shall be recorded as it would have been done between independent enterprises in comparable transactions and under comparable circumstances.
- The Arm's Length Principle has been introduced under Article 12 of the Law, which provides that the Constituent Entity Income or Loss for a fiscal year shall be the Financial Accounting Net Income or Loss of that Fiscal Year after various adjustments as provided under said Article, including adjustments in respect of cross border transactions of the Constituent Entity to ensure arm's length.
- It is to be noted that the Regulation, in Article 13, specifically mentions about adjusting the outcome of transactions undertaken by the Constituent Entity with another Constituent Entity of the same MNE Group, located in a different jurisdiction to arrive at the Constituent Entity Income or Loss.
- Accordingly it can be inferred that it covers only cross border transactions between Constituent Entities of the same MNE Group, with an exception being transactions relating to loss on sale or transfer of asset between Constituent Entities of the same MNE Group within the Kingdom, which

shall be adjusted by applying the arm's length principle to arrive at the Constituent Entities Income or Loss.

- However MNE's may need to evaluate this factor considering that Clause E of Article 13, mandates all transactions between in- scope Constituent Entities even within the Kingdom to comply with local file and master file requirements.

## Transfer Pricing Methods

- For the purposes of applying the arm's length principle, the Law provides for the use of the most appropriate method considering the facts and circumstances of the transaction. No priority of methods have been prescribed.
- For determination of the arm's length result of a transaction or arrangement between Related Parties the Law prescribes the application of one of the following methods which are in line with the OECD TP Guidelines:-



- It is to be noted that the Law does not recognise the use of 'Other method' as provided by the OECD guidelines. The Other Method is generally used where the business can demonstrate that the specified methods cannot be reasonably applied to determine an arm's length result.
- Further the Law does not specifically allow the use of multiple / combination of methods for determining the arm's length result.

## Documentation Requirements

- With the introduction of local file and Masterfile, Bahrain is aligning itself with the 3 tier documentation approach of the OECD as Country by Country reporting (CbC) regulations are already implemented in Bahrain.
- In scope- Constituent entities within the kingdom are mandatorily required to maintain master file and local file. Documents under these Regulations shall be kept and maintained for a period of five years following the end of the Fiscal Year to which they relate.

- The contents of the Master File and Local File as per the Law is as below:

Master File Contents	Local File Contents
Master file should provide an overview of the MNE Group business, including nature of its global business operations, its overall transfer pricing policies etc The information to be documented in the Master file can be categorized into the following groups:	The Local file provides more detailed information relating to transactions between Constituent Entities pertaining to a particular jurisdiction.  The important information to be included in the Local file are:
1. Organisation Structure	1. Details of Transactions between Constituent Entities
2. Description of MNE group's business(es)	2. Group Overview
3. MNE group's intangibles	3. Industry Overview
4. MNE group's intercompany financial activities	4. Functional, Assets and Risk Analysis including significant changes if any, compared to prior years
5. MNE group's financial and tax positions including APA and other tax rulings relating to allocation of income among countries	5. Comparability Analysis including details of comparability adjustments made to the results of Tested party or comparables or both, and details of significant changes if any compared to prior years

### Advance Pricing Agreement (APA)

- There is a reference to APAs in Article 13 which states that where a bilateral or multilateral Advance Pricing Agreement has been agreed by the relevant competent authorities of the jurisdictions of the Constituent Entities, the adjustment to the Constituent Entity Income or Loss shall be applied consistently in accordance with the arm's length price agreed under the Advance Pricing Agreement. Hence it appears that Bahrain is bringing in the APA regime as well for tax certainty.

### Administrative Procedures

- Registration:
  - Filing Constituent Entity shall apply for registration within 120 days from the first day of the transition year, or
  - Within 30 days following the date on which the Law comes into force i.e. January 31, 2025 if the Revenue threshold is met for two out of the past four fiscal years.
  - The Filing Constituent Entity will be required to submit registration application which shall contain details on the MNE group, ownership structure, fiscal year of UPE, Constituent entities, JV's and JV subsidiaries of the MNE Group, Financial Information and written consent from relevant entities. The Bureau will issue a registration certificate on acceptance.
- Deregistration: An application for deregistration must be made within 30 days when any of the following cases:-
  - Revenue Threshold is not met for 5 consecutive years

- MNE Group does not have any Constituent Entities, Joint Ventures, Joint Venture Subsidiaries due to liquidation, dissolution etc.,
- The Group is no longer an MNE Group
- Any other circumstances

If the filing constituent entity does not file for deregistration, then the Bureau can deregister the entity.

- Appointment of Filing Constituent Entity
  - The Filing Constituent Entity must file a written consent from all Constituent Entities in the Kingdom to the Bureau.
  - Where the Filing Constituent Entity ceases operations or leaves the MNE Group, a new Filing Constituent Entity must be appointed within 30 days from the date of the occurrence of such event.
- Tax return:
  - The Filing Constituent Entity must submit a tax return within 15 months of the last day of the Reporting Fiscal Year,
- Payment of Tax
  - A Filing Constituent Entity shall pay advance payments of Tax for each full three-month period during a Fiscal Year
  - Where the length of the Fiscal Year is shorter than three months, then no advance tax payments arises
  - The balance of tax due must be paid within 15 months of the end of the fiscal year.



## Conclusion

The DMTT Law and the Transfer Pricing provisions are more or less aligned to the Globe Rules and the OECD Guidelines.

With the applicability of DMTT Law commencing from 01, January 2025, the MNEs having Constituent Entities in the Kingdom will need to assess the applicability of the said provision and evaluate its impact so as to ensure smooth transition, within a short time.





## How Can We Support

### Transfer Pricing Compliances

- Determining applicability of the Law to Constituent Entities within Bahrain.
- Analysis of transactions that would be covered under the Bahrain TP regime
- Undertake TP benchmarking analysis for the covered transactions to be in line with the arm's length principle.
- Assist with regular TP compliances Master file, Local file, CbC report

### Transfer Pricing Advisory

- Price Setting- Advice on suitable pricing model and transfer pricing policy
- Assistance in implementation of TP policy and periodic review of margins earned
- Review/Drafting of intercompany agreements for the covered transactions
- Supply chain Re-Structuring
- Possible Advance Pricing Agreement assistance, once rules are notified
- Advice on Intra-Group Services, Management Charges, royalty, Cost Contribution Arrangements and financing transactions
- Support on estimating the profit attribution to Permanent Establishments
- Impact Analysis for Pillar 2

### About us



VSTN Consultancy Private Ltd is a boutique Transfer pricing firm with extensive expertise in the field of international taxation and transfer pricing. VSTN Consultancy has been awarded by **International Tax Review (ITR) as Best Newcomer in Asia Pacific – 2024** and is recognised as one of the **finest performing transfer pricing firms**.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, Global Documentation, BEPS related compliances (including advisory, Masterfile, Country by Country report), safe harbour filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

We are structured as an inverse pyramid where leadership get involved in all client matters, enabling clients to receive the highest quality of service.

Being a specialized firm, we offer advice that is independent of an audit practice, and deliver it with an uncompromising integrity.

Our expert team bring in cumulative experience of over six decades in the transfer pricing space with Big4s spanning clients, industries and have cutting edge knowledge and capabilities in handling complex TP engagements.



VSTN Consultancy Pvt Ltd., © 2024. All Rights Reserved.