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Tax alert

Multilateral Instrument – Developments

Bahrain signs Multilateral Convention (“MLI”)

29 November 2020

On 27 November 2020, Bahrain signed the MLI to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) – becoming the 95th jurisdiction to join the MLI.

What is MLI?

MLI is a common agreement between multiple jurisdictions which allows them to swiftly integrate the BEPS inspired tax treaty changes into their existing networks of Double Tax Treaties (DTT) without having to amend the individual tax treaties. Such changes may cover a range of tax treaty matters but the key areas are focused on prevention of treaty abuse and improving the resolution of tax treaty related disputes between jurisdictions.

Implications for Bahrain

Each jurisdiction, including Bahrain, is required to confirm the DTTs to be covered under the MLI (Covered Agreements) and to provide a list of provisional reservations and notifications (MLI positions) at the time of signature. The MLI positions may be subject to change and the definitive outcome will be provided upon the ratification of the MLI by Bahrain through a local legislative process. The specific changes in Bahrain’s DTT with a particular jurisdiction is also dependent on the counterparty jurisdiction signing the MLI and their status of the MLI positions.

Bahrain has chosen to include 44 DTTs under the Covered Agreements which could potentially be amended by the MLI. Bahrain has made, among others, the following key MLI positions:

- Bahrain has chosen to combat treaty abuse through adopting the Principal Purpose Test (PPT). This satisfies Bahrain’s one of four BEPS minimum standards in relation to Action 6: Prevention of Tax Treaty Abuse. Upon entry into force of the MLI, this change would likely make claiming treaty benefits more difficult for non-resident taxpayers since they will have to prove that obtaining a treaty benefit under such a treaty was not one of the principal purposes of undertaking an arrangement or transaction.

- Bahrain has chosen to ensure all covered agreements would include a Mutual Agreement Procedures (MAP) process that would efficiently resolve any disputes in relation to application of DTT provisions. This also satisfies another BEPS minimum standard in relation to Action 14: Making Dispute Resolution Mechanisms More Effective.

Due to the nature of the MLI as a global instrument, the measures provided for in the MLI automatically modify the bilateral DTTs of the signatories so there is no need to renegotiate such treaties.

What's next?

The signing of the MLI is an important development for Bahrain's tax treaty network. Under the PPT, treaty benefits would be denied where one of the principal purposes of an arrangement is to secure a benefit under the treaty, such as a reduction in (or exemption from) source taxation on dividends, interest, or royalties, permanent establishment (PE) exemption, or capital gains tax protection.

As the PPT is not easy to apply, it remains to be seen how it will operate in practice - it will be even more important that any arrangements be clearly linked to a core commercial activity.
Multinationals operating in Bahrain should review their holding, financing and operational structures to ensure that they remain relevant in light of current and potential business needs and BEPS developments. New investments into, from or through Bahrain will need to take into account the expected changes.

The above is for general information only and is not intended to address the circumstances of any particular scenario. please seek professional advice in relation to your particular circumstances.

For more information, please contact us.

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