



# Economic Substance Requirement

## Kingdom of Bahrain

In 2013, the Organisation for Economic Co-operation and Development (“OECD”) and G20 adopted the Base erosion and profit shifting (“BEPS”) project to develop an Inclusive Framework (“IF”) to curb tax avoidance, particularly through shifting profits to low or zero-tax jurisdictions. Action Plan 5 of IF requires member countries to ensure substantial economic activity exists for any preferential tax regime and to enhance transparency via information exchange.

Bahrain joined the IF on 11 May 2018 and committed to implement its minimum standards, including Action Plan 5. Accordingly, the Central Bank of Bahrain (“CBB”) issued a directive on 22 November 2018, effective 1 January 2019 for regulated financial institutions, and the Ministry of Industry and Commerce (“MOIC”) issued Ministerial Order No. 106 of 2018 (“Order”), effective 27 December 2018 for non-regulated commercial activities. Additional guidance was issued on 17 September 2020 for geographically mobile activities.

### Relevant Activities:

Entities carrying out the following Economic Substance Regulations (“ESR”) - covered activities must demonstrate and report adequate economic presence in Bahrain:

Non-CBB licensed entities	CBB licensed entities
Distribution & service center activities	Banking
Activities of head office	Financing companies
Holding company activities	Insurance licensees
Leasing activities	Investment business firms (Cat. 1)
Shipping activities	Investment business firms (Cat. 2)
Intellectual Property activities	Fund administrators

On 3 June 2020, MOIC issued a list of Commercial Registration (“CR”) activity codes falling under ESR. Entities should review both CR codes and actual operations to assess ESR applicability and amend CRs if necessary.

### Economic Substance Tests:

Entities engaged in relevant activities must satisfy the following tests:

- ▶ **Applicability Test** - Determines if CIGA (Core Income Generating Activities) are performed in Bahrain and checks adequacy of local resources (employees, expenses, offices).
- ▶ **Pure Equity Holding Test** - Applies to entities solely holding equity and earning dividends/capital gains; classified via analysis of balance sheets and equity structure.
- ▶ **Management Test** - Assesses whether the activity is directed and managed in Bahrain, requiring board meetings, quorum, and decision-making within Bahrain.

### Economic Substance Tests (Contd.):

- ▶ **CIGA Test** - Confirms actual conduct of core business activities in Bahrain.
- ▶ **Adequacy Test** - Reviews sufficiency of employees, governance, office space, policies, accounting records, and Board oversight aligned with business scale.
- ▶ **Other Requirements Test** - Ensures changes in shareholders or directors comply with MOIC authorisations.
- ▶ **Outsourcing Test** - Evaluates if CIGA are outsourced within Bahrain and assesses governance over third-party activities.
- ▶ **IP CIGA Test** - Entities with IP assets are presumed not to meet substance unless they demonstrate control over development, enhancement, and use of IP by skilled Bahrain-based employees.

### Reporting Requirements:

Entities must submit annual ESR reports to the respective authority:

- ▶ **CBB-licensed entities:** Report due within 3 months after the financial year-end (e.g., by 31 March 2025 for FY ending 31 December 2024).
- ▶ **Non-CBB entities (MOIC):** Although the Order sets no statutory deadline, MOIC requires filing via ITIES within 3 months post-FY end. Deadlines may be extended by circular; however, for FY 2024, MOIC advised filing once the audit is completed.

### Enforcement Measures:

In March 2024, MOIC clarified that **no further extensions** will be granted for submitting audited financial statements. For FY ending 31 December 2024, the filing deadline for submission of Audited FS was **30 June 2025**. This move indicates tighter enforcement of ESR compliance by MOIC.

### Implications for non-compliance:

Non-compliance may lead to

- ▶ Suspension or revocation of CR/license,
- ▶ Administrative fines up to BHD 100,000,
- ▶ Criminal charges, imprisonment, or further investigation.

### BDO offerings:

Our Bahrain tax team can assist with ESR applicability assessment, Gap analysis and recommendations, Supporting documentation review, ESR return filing and submission, and Response to Authority queries or clarifications.

For support, contact our tax professionals to schedule a call or meeting.

#### Contact Us



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