



Bahrain

The deadline to file the Economic Substance (ES) Return for Bahrain entities is 31 March 2021 (for the financial year ended 31 December 2020)

Background to ES Rules

The Ministry of Industry, Commerce and Tourism (MoICT) and the Central Bank of Bahrain (CBB) issued a Directive OG/499/2018 (CBB Directive) on 22 November 2018 and a Ministerial Decision no. 106 (MO 106) on 27 December 2018 (collectively 'Economic Substance Rules' or 'ESR') imposing substance requirements for Bahraini entities undertaking geographically mobile activities in, from or through Bahrain.

Why have the ES Rules been enacted?

Governments around the world are increasingly concerned about money laundering and financial crime, enacting and enforcing appropriate legislation and regulations to curb contentious behavior and activities within the marketplace. This also has a domino effect on tax and commercial laws as authorities remain focused on the risks that may arise from corporate structures that shift income or profits to entities in jurisdictions with no or low tax regimes. The Organization for Economic Co-operation and Development (OECD) enacted the Economic Substance rules and the Base Erosion and Profit Shifting (BEPS) framework to counter organizations from exploiting gaps and mismatches from different countries' tax protocols.

The Kingdom of Bahrain has joined the OECD's inclusive framework on BEPS and have also effectively implemented key protocols in relation to the ES rules.

Who do the rules apply to?

The ES rules apply to entities (corporations, branches and partnerships) that are carrying on one or more of the following relevant activities:

- Distribution and service centre
- Headquarters
- Holding company
- Leasing
- Shipping
- Intellectual property (IP)
- Banks
- Financing companies
- Insurance
- Investment firms (CBB categories 1 & 2)
- Fund administrators

Some of the above activities are regulated by the CBB and therefore those CBB regulated entities will need to report to the CBB. Please click [here](#) for a handy decision tree on whether the rules apply to your entity.

Who monitors the ES rules?

The ES rules and BEPS framework are monitored and regulated by the MoICT and the National Bureau for Revenue in the Kingdom of Bahrain. Companies, and more importantly business leaders will need to consider how to ensure that their organizations and the respective governance and compliance practices are enhanced, and the necessary processes and practices are introduced to safeguard the company and its shareholders.

What must entities prove?

Entities undertaking one or more of the relevant activities must meet the ES tests – they must prove that they have genuine commercial operations and management in Bahrain.

Substance over form

On 3 June 2020, the MoICT issued a list of commercial registration (CR) activity codes which the MoICT considered to be relevant activities under the ES rules. It appears that the MoICT only requires entities whose activities are mentioned in this list to comply with the ESR.

This has created confusion among entities as to whether a “substance over form” approach should be adopted. In the UAE for example, a licensee must look beyond what is stated in the commercial license to the activities **actually** undertaken by the licensee during a financial period in order to determine the applicability of the ESR. In practice, we have seen some entities in Bahrain that have not updated their CRs since their incorporation having to comply even though they are not actually carrying out a relevant activity. In contrast, entities which are carrying out a relevant activity but their CR activity code is not in the MoICT list are not having to file an ES return. Ultimately, all these entities will need to carefully consider the activity codes listed under their CR and the actual activity they are undertaking and amend their CRs. In our view, the entity should review the actual activities they are undertaking and assess (regardless of what their CR states) whether they are carrying out a relevant activity and therefore comply with the ES rules.

What is the reporting deadline?

The deadline to file the ES return for Bahrain entities is 31 March 2021 (for the financial year ended 31 December 2020). Whilst the MoICT (due to Covid-19) extended the reporting deadline last year, we do not expect a similar concession to be given this year. For CBB regulated entities, extension of time last year was only granted by the CBB on a case by case basis.

What are the consequences for non-submission of the ES return?

Since July 2020, the MoICT has been issuing violations against entities that had failed to submit their ES returns by the mandated deadline. Consequently, these entities were not able to renew their CRs until the violation was corrected. We understand that this was not based on an assessment or audit by the MoICT as to whether entities were meeting the ES rules but it was done to ensure those entities with a CR activity codes falling within a relevant activity under the ES rules filed their ES returns. We expect the MoICT to review ES return filings in due course to assess those entities that may not be complying with the substance requirements.

We recommend all impacted entities file their ES returns urgently as delays may not only result in an inability to renew CRs but the imposition of financial penalties.

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

For a detailed discussion on how the above may impact your business, [contact us](#).

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