

Ministry of Industry
and Commerce



وزارة الصناعة والتجارة

Economic Substance for Geographically Mobile Activities in the Kingdom of Bahrain

GUIDELINES

Issued pursuant to Ministerial Order No. (106) of 2018 Concerning
Economic Substance Requirements in the Kingdom of Bahrain
("MO")

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Glossary

The table below lists terms that will be used throughout this guide and their meaning:

Term	Meaning
MO 106	Ministerial Order no. 106 of 2018 concerning economic substance in the Kingdom of Bahrain.
ES	Economic Substance
MOICT	Ministry of Industry, Commerce, & Tourism
CIGA	Core Income Generating Activities
UPE	Ultimate Parent Entity
UBO	Ultimate Beneficial Owner
IPE	Intellectual Property Enterprise

MNE	Multinational Entities
Return	The form/report that traders will be required to submit to MOICT
Guidelines	A guide that explains economic substance requirements in Bahrain, issued by MOICT.
Sijilat	The online portal of MOICT through which traders can manage their entities.

Introduction

In order to meet the European Union criterion 2.2 and Base erosion and profit shifting (BEPS) Action 5 minimum standard, the Kingdom of Bahrain is required to impose economic substance requirements on traders that carry on geographically mobile business activities.

Therefore, the Ministry of Industry, Commerce, & Tourism (MOICT) and the Central Bank of Bahrain (CBB) have issued Ministerial Order number 106 of 2018 and Directive (OG/499/2018) respectively, which provide an initial guidance on demonstrating Economic Substance.

The purpose of the ministerial order is to enhance economic substance requirements in the Kingdom of Bahrain and clarify the requirements for any Traders carrying out certain types of Relevant Activities in or through Bahrain (other than those activities undertaken by licensees of the Central Bank of Bahrain).

The ultimate goal of the ministerial order is to prevent international businesses from benefiting from different tax laws between countries by artificially transferring profit to jurisdictions that impose little or no income tax.

The ministerial order came into effect on 1st of January 2019 for new commercial registrations (CR) and existing CRs that apply to any of the relevant activities mentioned in this document. For all other CRs, this ministerial order will come into effect on 1st of July 2019.

Purpose of this Guide

The purpose of this document is to serve as a preliminary guide to relevant traders on the scope and application of the economic substance requirements, i.e. to assist relevant traders carrying on relevant activities to understand how to satisfy the ES Test.

It is intended to serve as a guide advising traders undertaking IP and other relevant activities (all traders covered by the Ministerial Order 106) of what information they are required to file with the MOICT in order to comply with the said Ministerial Order.

The aim is to:

1. Provide greater certainty for the relevant traders of understanding and compliance with the MO 106. Licensees which are covered by the CBB Directive are not addressed by this guidance.
2. Ensure that relevant traders file a timely and meaningful report.
3. Avoid onerous, excessive and unnecessarily information on traders.

This document should be read in conjunction with Ministerial Order number 106 of 2018. It should also be treated as a work in progress as additional requirements may arise through further discussions with the Organization for Economic Cooperation and Development (OECD) Forum on Harmful Tax Practices (FHTP).

Additional laws/ministerial orders concerning the economic substance will be introduced in the future for any new requirements that arise.

Relevant Trader

The traders within scope would be those traders formed under the MOICT legislations that are carrying on a relevant activity, which can be identified as follow:

1. Distribution and service center activities
2. Headquarters activities
3. Holding company activities
4. Leasing activities (other than those activities undertaken by licensees of the Central Bank of

Bahrain)

5. Shipping activities
6. Intellectual property activities in Bahrain
7. Banks (covered in CBB's directive)
8. Financing companies (covered in CBB's directive)
9. Insurance (covered in CBB's directive)
10. Investment Business Firms (covered in CBB's directive)
11. Fund Administrators (covered in CBB's directive)

The Ministerial Order requires a relevant trader that is carrying on relevant activities to satisfy the Economic Substance Test in relation to each relevant activity. Such a relevant trader will also have notification and reporting obligations under the Ministerial Order 106.

The term “relevant activity” does not require a trader to be actively engaged in the businesses listed above, i.e. passive collection of income from one of the foregoing businesses would be a relevant activity.

Any commercial trader, which is not engaged in any of the aforementioned activities, is not a relevant trader and it is not required to file a substance report.

Applicability Test

Demonstrating a substantial economic presence can be satisfied by way of a two-part test:

The first part of the test determines whether the relevant trader is conducting its core income-generating activities (CIGA) in The Kingdom of Bahrain. Industry-specific CIGA are outlined in article 3 of the MO 106. Licensees which are covered by the CBB Directive are not addressed by this guidance. Traders are encouraged to refer to the MO to determine the CIGA relevant to your trader. The CIGA should be undertaken with:

- An adequate amount of annual operating expenditure;
- An adequate level of qualified full-time employees; □ An adequate number of physical offices.

A relevant trader is prohibited from outsourcing any of its core income-generating activities to any trader or person outside of The Kingdom of Bahrain; but it may outsource such activities to a service provider within Bahrain provided that the relevant trader is able to demonstrate that the core income

generating activities were performed in Bahrain. In addition, it must show that it has performed adequate supervision measures in Bahrain on the outsourced activities.

The second part of the test determines whether the relevant trader's direction and management in relation to its relevant activities are located in The Kingdom of Bahrain, which is satisfied by five requirements:

1. An adequate number of meetings of the relevant trader's board of directors must take place in Bahrain;
2. At least a quorum of the board must be physically present in Bahrain during the meetings;
3. Strategic decisions concerning the relevant trader must be made at the above-mentioned meetings and recorded in the meeting minutes;
4. All the relevant trader's records and minutes must be kept in Bahrain;
5. The board of directors as a whole must possess the necessary knowledge and expertise to discharge its duties.

Please note that more details of the above will be covered at the end of this guide in Appendix 4 (Bahrain Substance Requirements Chart).

Information reporting

The MO 106 requires all registered traders who are conducting any of the above activities to file an annual return with the MOICT. These returns are submitted through the Ministry's Sijilat system either by the trader or his agent, i.e. Auditor or professional body. Licensees which are covered by the CBB's directive are not addressed by this guidance.

Generally, the Economic Substance report includes but is not limited to:

1. Core Income Generating Activities (CIGA) of a trader
2. Structure of the board (number, names, nationality, experience)
3. Number and place of board members' meetings
4. Strategic decisions, including where they are taken

5. Number, experience, qualification, duration of employment and type of contracts of employees
6. External auditor name and terms of contract with services provided.
7. Annual operating expenditures and annual income
8. Physical address / offices of the trader
9. Traders' confirmation (with explanation) that an adequate set of internal policies and controls for trader's operations are maintained
10. Traders' confirmation that they are maintaining adequate and proper books of accounts that contains type of business, amount and type of gross income, and amount and type of expenses.
11. Detailed business plan which clearly ascertains the commercial rationale of holding IP assets in Bahrain (**this is applicable to high risk IP traders only**).
12. Traders' confirmation with supporting concrete evidence that decision making is taking place in Bahrain.
13. Trader's confirmation with supporting explanations and documents that there were adequate premises, number of staff, income, expenditure incurred
14. Trader's confirmation with supporting explanations and documents as an annex about any outsourced activities.

15. Notification if any of resignation of directors and officers responsible for managing the traders.
16. Immediate and ultimate parent entity, and ultimate beneficial owner of the Trader, together with their jurisdiction of tax residence

Traders must report the required information under the substance framework on an annual basis within three months after the last day of the end of each fiscal period.

Traders that claim the domestic entity exemption as set out in question 2- 4 of Part A of the ES return shall provide in their annual ES return detailed information on each of their relevant activities.

The monitoring and enforcement of these substance rules will be carried out by the Ministry of Industry, Commerce and Tourism. The enforcement of these rules are supported in the legislation by financial penalties for non-compliance and the ability to strike off traders from the register.

Core Income Generating Activities (CIGA)

Core Income Generating Activities (CIGA) are activities that consist of those principal functions that drive the business value (rather than exclusively or mostly administrative support activities). In other

words, they are the key essential and valuable activities that generate the majority of income for traders.

It is not necessary for the trader to perform all of the CIGA listed in the legislation (i.e. article 3 of MO106) for the particular sector, but it must perform the CIGA that generate the income it has.

As mentioned earlier, in order to meet the economic substance requirement, the CIGA that generates the income must be performed in the Kingdom of Bahrain. Where the CIGA involves making relevant decisions, then the majority of those making the decisions must be present in Bahrain when the decision is made, otherwise the decision will not be considered to be made in Bahrain and hence trader will not pass the substance test.

CIGAs include:

□ **Distribution and Service Center Activities**

The definition covers companies that generate income from the following:

- a) Purchasing raw materials and finished products from other group members and reselling these;
or
- b) Providing services to other traders of the same group,

Examples:

ABC W.L.L

ABC W.L.L buys Heavy machineries from other group companies based in Asia and re-sells them to other group companies and customers in Europe. These activities are within the scope of the definition, therefore ABC W.L.L is subject to the substance requirements.

XYZ B.S.C

XYZ B.S. C's main activity is to provide administration services to another group trader based in Europe, which are recharged at cost. These activities are within the scope of the definition, therefore XYZ B.S.C is subject to the substance requirements.

HAH W.L.L

HAH W.L.L is the service trader for an audit and accountancy partnership where its main activity is to provide services to customers in the Kingdom of Bahrain. HAH W.L.L employs the staff and owns the premises used for the business of the partnership. Another group trader based in the UK requires specialist IT skills, which sit within HAH W.L.L and requests those skills for a period of 3 months, agreeing to reimburse costs. As HAH W.L.L is not in the business of providing those services to other group

companies, nor does it offer/solicit such services or maintain employees to provide such services, HAH W.L.L is not considered to be providing services and is therefore not conducting the relevant activity. HAH W.L.L is not subject to the substance requirements.

Core Income Generating Activities (CIGA) for Distribution and Service Centre

The legislation – MO 106 sets out a list of CIGAs for distribution and service centers, which are described below.

- a) Transporting and storing goods - refers to the movement and storage of raw materials or finished products and managing the risks associated with this.
- b) Managing stocks - includes considering minimum acceptable stock levels, managing frequency of stock take, whether using storage space effectively, perishability of stock and ensuring security procedures are in place.
- c) Taking orders - includes the provision of the order processing element of the entire fulfilment process, whether manual or electronic.
- d) Providing consulting or other administrative services - includes providing such services, which are offered or solicited to other group companies, usually with a mark-up.

Examples

The examples provided in this section are for illustrative purposes. It is important to note that where a distribution & service center activity conducted by a Trader is not the main activity of the Trader, the Trader is still subject to the ES requirements for distribution and service center activities as set out in the MO 106.

ABC W.L.L

ABC W.L.L is a Bahraini trader that provides administrative services to other traders of the same group. It employs qualified individuals in the Kingdom of Bahrain who record how their time is spent in order that this can be billed to the relevant trader at the agreed rate. The directors of ABC W.L.L will recruit and train employees according to the anticipated needs of other group companies. The trader will be regarded for the purposes of the substance requirements as carrying out the CIGA of providing administrative services in Bahrain.

XYZ W.L.L

XYZ W.L.L is a distribution trader based in the Kingdom of Bahrain, responsible for the distribution of raw materials purchased from group entities in Asia, to other group entities based in Europe.

XYZ W.L.L contract transportation of goods to another non-resident trader HAH Ltd. Goods are then stored in a UK warehouse by a third-party trader STO Ltd, who liaise directly with HAH Ltd over deliveries. The board of XYZ W.L.L do not oversee the activities of HAH Ltd nor STO Ltd.

As the board and the employees of XYZ W.L.L do not undertake the relevant CIGA at all, XYZ WLL will not satisfy the substance requirements.

□ **Headquartering / Head office activities**

The definition covers traders that provide headquarters services to other non-resident members of the same group. Headquarters will take responsibility for the overall success of the group, or an important aspect of the group's performance. Such headquarters services include:

- a) The provision of senior management
- b) Taking responsibility or control of material risk for activities carried out by, or assets owned by, any of those members
- c) The provision of substantive advice in relation to such risks

In banking, insurance, fund management, financing and leasing, shipping or distribution and service center businesses it may be a normal part of their activities to provide headquarters services, and so these activities are excluded from being within the scope of Headquarters to prevent duplicate reporting. However, these businesses will still need to comply with CIGA for headquarter activities of the Central Bank of Bahrain.

Examples:

ABC W.L.L

ABC is a W.L.L Bahraini trader, which is part of a group, with subsidiaries around the world. The senior management team each have responsibility for a different region and will regularly spend time at the subsidiaries with the senior management teams providing strategic direction and helping manage material risks. These activities are within the scope of the definition, therefore ABC W.L.L is subject to the substance requirements.

XYZ B.S.C

XYZ is a B.S.C trading trader based in Bahrain that has subsidiaries in the UK. Whilst the senior management team of XYZ B.S.C have regular dialogue with staff at the subsidiaries, the senior management team of each subsidiary set their strategic direction and manage risks in line with the corporate policy set by the headquarters based in USA. XYZ B.S.C is not considered to be providing headquarters services and is therefore not subject to the substance requirements.

Core Income Generating Activities (CIGA) for Headquarters

The legislation – MO 106 sets out a list of CIGA for Headquarters, which are described below.

- a) Taking relevant management decisions refers to making decision on the substantive functions, and significant risks for other group/connected companies including strategic planning, marketing strategies, acquiring premises, etc. For a decision to be determined as being taken in a jurisdiction for the purposes of this CIGA, the majority of board members and the quorum

necessary for such a decision to be taken in relation to the relevant activities, should be physically present in that jurisdiction.

- b) Incurring expenditures on behalf of group traders includes the taking of specialist advice or procuring technology on behalf of the group as a whole or purchasing significant assets / specific services for / on behalf of a group trader.
- c) Coordinating group activities includes ensuring where there are specific advantages to the group, group traders' activities are co-ordinated in a way that produces the best outcome for the group rather than the individual companies. E.g. If as a whole a group can get better terms from a supplier if they enter a Pan-European Deal, or any part of the world ensuring that all the group traders enter the deal, even if it is not the best deal for a specific trader.

Examples

ABC S.P.C

ABC is a S.P.C based in Bahrain, which is the regional headquarters for a global group.

The directors of ABC S.P.C are responsible for the success of the region, setting the strategic direction and managing risk. The senior management team of ABC each have responsibility for a different area

within the region, and regularly spend time with the leadership teams of the subsidiaries providing strategic direction and helping manage material risks.

ABC S.P.C takes specialist advice on matters of compliance relevant to the region, with staff disseminating that advice and coordinating activities to ensure compliance of all subsidiaries.

Each quarter the directors will review the regional performance and risk profile, ensuring they take steps to manage any risks.

The trader will be regarded for the purposes of the substance requirements as carrying out CIGA in the Kingdom of Bahrain.

ZYX W.L.L

ZYX W.L.L, based in the Kingdom of Bahrain, is the headquarters for a small group of non-Bahraini traders. ZYX provides the senior management team, assumes and controls risks for the activities and assets of the group companies and provides advice to the group companies on the control of risk.

The board of directors of ZYX W.L.L act as the senior management team for the group companies. All members are resident outside Bahrain.

Although they hold an annual board meeting in Bahrain, all the relevant management decisions are taken outside the Kingdom of Bahrain.

All meetings, deliberations and decisions in relation to the incurring of expenditures on behalf of group traders take place outside Bahrain.

As the board and the employees of ZYX W.L.L does not undertake the relevant CIGA in Bahrain, ZYX W.L.L will not satisfy the substance requirements.

□ **Holding company activities**

A holding company could be a (Pure Equity) or, additionally, it can also undertake other commercial activities.

The sole activity of a pure equity holding company in all cases is holding equity participations in other traders and earning dividends and capital gains. A pure equity holding company has adequate substance if it:

- a) Complies with its statutory obligations under commercial law requirements.
- b) Has adequate level of qualified full-time employees' resident in Bahrain.
- c) Has adequate physical offices/premises in Bahrain to hold and manage equity participations.

Additionally, if a holding company also undertakes other commercial activities, then it is outside of this narrow definition and will instead need to meet the higher substance requirements, if applicable to any relevant activity it carries on.

Indicator

Key indicator proposed for the identification of Holding Companies is the share of equity in Subsidiaries. As stated above, holding shares of subsidiaries is the sole activity of a pure holding company and the pure holding company does not carry on any commercial activity.

Therefore, using information on the structure of the balance sheets, holding companies can be identified as a trader which generally has all or almost all of the assets, as shown in the balance sheet, as equity interest.

Examples:

ABC B.S.C

ABC B.S.C is a holding company which provides senior management, takes responsibility, control or provides substantive advice in respect of material risks to companies it controls. ABC B.S.C, will not be a (pure equity) holding company. The company could be considered to carry on the activity of providing headquarters services if those services were provided to foreign companies.

Nero B.S.C

Nero B.S.C is an intermediary (pure equity) holding company in a group structure, it holds 100% of the shares in three other companies and receives dividends annually. This is Nero B.S. C's only activity. Nero is a (pure equity) holding company.

Restau W.L.L

Restau W.L.L runs 2 restaurants. It has also acquired all the shares in another trader, Bistro W.L.L, which is constructing a new restaurant. Resto W.L.L will not be a (pure equity) holding company as besides holding shares it is in the business of running restaurants.

Core Income Generating Activities (CIGA) for Holding Company

The legislation MO 106 sets out a list of CIGAs for a Holding Company, which are described as those activities that are associated with the income that the holding companies earn (such as interest, rents, and royalties - which is generally associated with payments on intellectual properties i.e. rights to use an IP).

□ Leasing activities

Leasing can be simply defined as a rental agreement between two parties – lessor and lessee.

Broader definition can be used to describe a leasing as following:

A contractual agreement by which a legal owner (the lessor) of a specific asset, such as a parcel of land, building, equipment, or machinery, grants a second party (the lessee) the right to its exclusive possession and use for a specific period and under specified conditions, in return for specified periodic rental or lease payments. The lessee also agrees to abide by various conditions regarding their use of the property or equipment.

A lease can also be for Intangible properties such as use of a computer program (similar to a license, but with different provisions), or use of a radio frequency (such as a contract with a cell-phone provider).

Core Income Generating Activities (CIGA) for Leasing

The majority of those who conduct such activities will be regulated in relation to their activities under another heading, e.g. as a bank, insurance business, insurance intermediary, money service business,

investment business etc. However, there are some traders undertaking leasing activities that are not within the categories listed above.

The legislation MO 106 sets out a list of CIGA for leasing, which are described below:

- a) Identifying or acquiring assets to be leased, includes agreeing a suitable price or quantity, identifying sources of those assets, and negotiating the acquisition and the terms of supply.
- b) Setting the terms and duration of acquiring assets to be leased, includes the financial terms, the amounts, the legal agreements and the period for which leasing is to be provided.
- c) Monitoring and revising agreements, includes the acquisition of data about the lessee (or group of them), testing against covenants, and feeding back into decision making on writing new terms.
- d) Managing any risk, which includes monitoring and maintaining the underlying assets.

Examples

ACTA B.S.C

ACTA B.S.C is a Bahraini trader that works in a business of leasing properties. ACTA is responsible for acquiring the assets to be leased and to negotiate the price and duration. However, ACTA is not responsible for managing any risk neither now nor in future. Additionally, ACTA will not be allowed to monitor or alter any terms in the leasing agreement. As ACTA has no control over the lease agreement

and is not responsible for managing any associated risk, ACTA will not satisfy the substance requirements.

□ **Shipping activities**

'Shipping business' in the Economic Substance could be defined as any vessel operating in international waters (i.e. not in the local waters) for income, for the transport of passengers or cargo including the following activities:

- a) The business of transporting, by sea, passengers or animals, goods or mail for a charge;
- b) The renting or chartering of ships for the purpose described in paragraph (a);
- c) The sale of travel tickets and ancillary ticket related services connected with the operation of a ship;
- d) The use, maintenance or rental of containers, including trailers and other vehicles or equipment for the transport of containers, used for the transport of anything by sea; or
- e) Functioning as a private seafarer recruitment and placement service,

Economic Substance Test

If a Trader carries on the 'relevant activity' of 'shipping business' it will be subject to the economic substance test set out in the Economic Substance MO 106.

The economic substance test can be satisfied in relation to that 'shipping business' if the trader:

- a) Conducts the core income generating activities in Bahrain;
- b) Directs and manages its relevant activities in an appropriate manner in the Kingdom of Bahrain;
and
- c) Has adequate operating expenditure, physical presence and personnel in the Kingdom of Bahrain.

Core Income Generating Activities (CIGA) For Shipping Activities

The legislation – MO 106 sets out a list of CIGA for shipping activities, which are described below.

- a) Managing crew (including hiring, paying and overseeing crew members);

- b) Overhauling and maintaining ships includes procuring and/or overseeing the overhauling and/or maintenance of ships;
- c) Overseeing and tracking deliveries includes tracking package and cargo deliveries as part of the business services of the vessel;
- d) Determining what goods to order and when to deliver them, organizing and overseeing voyages including carrying out these activities by an agent or manager.
- e) Organizing and overseeing voyages.

Examples:

SEA Partnership

SEA Partnership is a shipping trader with its head quarter located in Bahrain and all management members permanently live in Bahrain. All decisions been taken collectively by partners who meets five times a year on the trader's premises. The trader has a fleet of seven ships which moves all over the world. SEA has alliance with many entities in Europe who have bigger fleets and more extensive shipping networks. Foxtan Ltd is a major business partner with SEA Partnership. SEA generates more than 70% of its income through that alliance by delegating most of its shipping to Foxtan to take advantage of Foxtan's more extensive shipping lanes and fleet.

As CIGA of the SEA Partnership will not be generated in Bahrain, SEA Partnership will not satisfy the substance requirements.

□ Intellectual property (IP) activities

Intellectual property (IP) asset could be defined as any intellectual property right in intangible assets, including but not limited to copyright, patents, trademarks, brand, and technical know-how, from which identifiable income accrues to the business. For the application of the MO106, the Ministry considers the term IP asset to include any such right from which identifiable income arises to the trader. In other words, such income is separately identifiable from any income generated from any tangible asset to which the right relates. This means, the term IP asset does not apply to a trader which owns IP assets merely as an adjunct to its business or sells a product or services having aspects derived from IP assets. In such a case, the income of the trader would be derived from the sale of finished goods to third parties, not from the exploitation of IP assets.

“Separately Identifiable Income” in respect of an intellectual property asset includes – a)

Royalties;

b) Income from a franchise agreement;

c) Income from licensing the intangible asset; and

d) Income from sale of an IP asset.

Core Income Generating Activities (CIGA) for IP Activities

The core income generating activities associated with an intangible asset will ultimately depend on the nature of the asset and will also depend on how that asset is being used to generate income for the trader.

The legislation - MO106 article 3 (f) sets out a list of the main CIGAs for Intellectual Property, which are described below.

For Intellectual Property activities – If the intangible asset is:

a) a patent – research and development activities;

b) a brand, trademark and customer data – branding, marketing and distribution activities;

The following activities (i) – (iii) can qualify as CIGAs for Intellectual Property only in certain exceptional situations where a trader can prove that it is undertaking CIGAs associated with income from any intangible asset without specifically undertaking the main CIGAs:

i. taking strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset; or ii. taking strategic decisions and managing (as well as bearing) the principal risks relating to the third-party acquisition and subsequent exploitation of the intangible asset; or

iii. carrying on the underlying trading activities through which the intangible assets are exploited, and which lead to the generation of revenue from third-parties.

When a trader is merely passively holding IP assets and /or have period meetings of non-resident board members, the economic substance requirements cannot be met.

Economic Substance Test

1. All traders conducting relevant activities, (whether IP or non-IP Activities) must ensure that:

a) The relevant activities are directed and managed in Bahrain (see point no. (2)),

b) It carries on core income-generating activity in relation to intellectual property assets in Bahrain

(see point no. (3)),

- c) There is an adequate level of appropriately qualified employees in Bahrain proportionate to the level of that activity carried on in Bahrain, whether or not employed by it or another trader and whether on temporary or long-term contracts,
- d) There is an adequate level of operating expenditure in Bahrain proportionate to the level of that activity carried on in Bahrain,
- e) There is an adequate physical presence in Bahrain (including, without limitation, offices and/or premises) proportionate to the level of that activity carried on in Bahrain, and the trader must be able to demonstrate that these requirements are or were complied with in each accounting period in which the requirements apply or applied in respect of it.

2. For the purposes of point 1 (a) above, a relevant activity is directed and managed in Bahrain if –

- a) The trader's board of directors meets in Bahrain with adequate frequency given the level of decision-making required of the board (and for the purpose of this subparagraph periodic decisions of non-resident board members are not taken into account),
- b) During each meeting of the board of directors in Bahrain, a quorum of the board of directors is physically present in Bahrain,
- c) Strategic decisions of the trader are made at meetings of the board of directors and the minutes of the meetings record those decisions,

- d) The board of directors, as a whole, has the necessary knowledge and expertise to discharge the duties of the board, and
 - e) All minutes of board meetings and all other trader records required by the Bahrain's Commercial Law to be kept by the trader are stored in Bahrain.
3. For the purposes of paragraph 1(b), an IP trader carries on core income-generating activity in relation to intellectual property assets in Bahrain, even if it outsources such activity provided that:
- a) The outsourcing is performed in Bahrain, and
 - b) The trader is able to demonstrate adequate supervision of the outsourced activity.
 - c) there will be no double counting if the services are provided to more than one trader.

Furthermore, if IP rights were acquired through a related party or obtained through the funding of overseas research and development activities such as under a cost-sharing agreement and are licensed to foreign related parties or monetized through activities performed by foreign related parties, there will be a rebuttable presumption that the trader does not have an economic substance in Bahrain.

Traders may rebut this presumption by providing the following information to the MOICT:

- A. A detailed business plan to clearly ascertain the commercial rationale of holding IP assets in Bahrain.
- B. Employee information including level of experience, type of contracts, qualifications, duration of employment.
- C. Concrete evidence that decision-making is taking place within Bahrain.

The above information provided to MOICT serves as proof that there is, and historically has been, a high degree of control over the development, exploitation, maintenance, enhancement and protection of the intangible asset that is also exercised by full time highly skilled employees that permanently reside and perform their core activities in Bahrain.

Adequacy test

The legislation – MO106 – refers to the term “adequate”. However, this term is not defined and therefore has its ordinary meaning. The dictionary definition of “adequate” is:

“Enough or satisfactory for a particular purpose”.

What is adequate for each trader will be dependent on the particular facts of the Trader and his business activity. It is important to note that the adequacy test for each trader will be assessed in relation with each relevant activity undertaken by the trader and the level of income generated by

it. The term “adequate” is chosen in order for it to be proportionate in relation to the activities being undertaken by the trader. This element of proportionality indicates that on a case-by-case basis, the number of full-time qualified employees, amount of expenditure, etc. should be separately evaluated and can differ per trader (depending on the business, activities and size of each trader). The idea was that instead of giving a particular number threshold, it should be the size that is necessary, appropriate, and reasonable for the particular business needs.

A Trader will have to ensure it maintains and retains appropriate records to demonstrate the adequacy of the resources utilized and expenditure incurred.

Traders must either practice the aforementioned CIGAs themselves or outsource them to third party service providers. In either case, the relevant activities of the traders and the third-party service providers must be managed and directed in the Kingdom of Bahrain.

Traders will be required to demonstrate adequate economic substance in the Kingdom of Bahrain.

The MOICT refers to this demonstration of economic substance adequacy as the “Adequacy test”, which includes:

- A. Adequate number of meetings between the board, managers, or partners of the traders held in Bahrain.

(What constitutes an adequate number of meetings will depend on the relevant activities of the trader. However, it will be expected that the majority of the board meetings, with a quorum of directors who are physically present, will be held in Bahrain.)

B. An Adequate set of internal policies and controls in the trader.

(What constitutes an adequate set of internal controls will depend on the relevant activities of the trader. Generally, the design of controls should be appropriate to the relevant activities' identified risks.)

C. Adequate records and books of accounts in Bahrain.

(Adequate records and books of accounts can be achieved by maintaining all documents received and issued by the trader and the timely recording of all business transactions. Moreover, the auditor's report will mention whether the trader has maintained proper books of accounts.)

D. Adequate level of qualified full-time employees proportionate to the activity.

(Adequate level of qualified employees depends on the relevant activities of the trader and its complexity. Qualifications that will be considered may include academic qualifications, vocational qualifications, relevant industry technical qualifications, and qualification by experience). Trader should clarify why this number was adequate to perform the CIGA.

- E. Adequate level of annual operating expenditure proportionate to the activity.
(Adequate level of expenditure may depend on the type of activity (some activities require a significant investment/expenditure), size of operation, age of trader, and share capital.) The trader must provide detailed breakdown of such expenditure and to clarify why this amount is adequate.
- F. Adequate physical offices/premises in Bahrain.
(Adequate physical offices may depend on the type of activity, the size of the operations, and the number of employees.) The trader must provide detailed description of such premises with their size and location and why trader believes that this is adequate.

Management test

As mentioned in the adequacy test section, relevant activities must be managed and directed in the Kingdom of Bahrain.

The MOICT refers to this as the “Management test”

A relevant trader complies with the requirement to be managed and directed in an appropriate manner in the Kingdom of Bahrain in relation to a relevant activity if -

- (a) Its board of directors, as a whole, has the appropriate knowledge and expertise to discharge its duties as a board of directors in relation to the relevant activity;
- (b) Meetings of the board of directors are held in Bahrain at adequate frequencies given the level of decision making required;
- (c) There is a quorum of directors present in Bahrain during the meetings described in (b) above;
- (d) The minutes of those meetings record the making of strategic decisions of the relevant trader at the meeting;
- (e) It keeps all such director meeting minutes and appropriate records in the Kingdom of Bahrain and must be readily available;

- (f) The trader's premises (whether leased, rented or owned) in Bahrain are adequate for the management of the relevant activity; and
- (g) Where the board of directors has decided to outsource the core-income generating activities in relation to the relevant activity, the board has maintained adequate supervision of those core-income generating activities.

Outsourcing test

The legislation – MO106 – does not prohibit a trader from outsourcing some or all of its activity. Outsourcing, in this context, includes outsourcing, contracting or delegating to third parties or group companies. However, there are some provisions of economic substance that must be met.

- A. If some or all of the CIGA is outsourced, the trader must be able to demonstrate that it has adequate supervision of the outsourced activities and, to meet the substance requirements, that those activities are undertaken in Bahrain.
- B. The outsourced activity is conducted in Bahrain i.e. no Trader shall outsource any of its core income generating activities to a trader or person outside Bahrain.
- C. Where a CIGA is outsourced, the resources of the service provider in Bahrain will be taken into consideration when determining whether the people and premises test is met.
- D. However, there must be no double counting if the services are provided to more than one trader.

The trader remains responsible for ensuring accurate information is reported on its return and this will include precise details of the resources employed by its service providers, for example based on the use of timesheets.

If the activity is not part of the CIGA this will not affect the trader's ability to meet the substance requirements. In addition, the substance requirement does not preclude traders seeking expert professional advice or engaging the services of specialists in other jurisdictions as is common worldwide and based on commercial necessity.

Where any part of the core income generating activities are outsourced in Bahrain, there must be adequate:

- A. Amount of annual operating expenditure; B.
- Levels of qualified full-time employees; and
- C. Physical offices within Bahrain.

Other miscellaneous requirements

A trader must inform MOICT of the following within 30 days:

- A. Resignation of directors and officers responsible for managing the Traders; B. Change of information regarding the place of business or office in Bahrain; and
- C. Change in constituent documents and business plans of the Traders.

A trader must also obtain approval from MOICT for any of the following:

- A. Establishment of offices outside Bahrain
- B. Change of shareholders
- C. Appointment of directors

Furthermore, a trader must be required to provide the MOICT information related to its immediate and ultimate parent entity and ultimate beneficial owner with their jurisdiction of tax residence.

Additionally, a trader must indicate its name and CR number clearly on its letterhead, documents, website, and social media platforms.

Finally, a trader must file a return / report to MOICT (with documentation) to prove that it has complied with all the requirements including the adequacy, management, and outsourcing tests. A trader who fails to submit such report will not be able to apply for a new CR nor renew an existing one.

Reporting to the Authority

A trader that is carrying on a relevant activity and is required to satisfy the ES Test must prepare and submit to the Ministry of Industry, Commerce and Tourism a report for the purpose of the Authority's determination whether the ES Test has been satisfied in relation to that relevant activity. Licensees which are covered by the CBB Directive are not addressed by this guidance.

The report must be made and submitted within three months after the last day of the end of each financial year of the relevant trader commencing on or after 1 January 2019. Such report shall be in the form approved by the Ministry and shall include the following information with respect to the relevant trader as of the end of the relevant financial year:

1. Type of relevant activity conducted
2. Jurisdiction of tax residency,
3. The amount and type of relevant income in respect of the relevant activity;
4. The amount and type of expenses incurred in respect of the relevant activity

5. The location of the place of business or plant, property or equipment in Bahrain used for the relevant activity
6. The number of employees with appropriate qualifications or personnel of third-party service provider in Bahrain who are responsible for carrying on the relevant activity;
7. Description of the core income generating activities conducted in Bahrain in respect of the relevant activity
8. Declaration as to whether or not the relevant trader satisfies the economic substance test in accordance with MO 106.
9. In the case of a relevant activity that is an intellectual property business- a declaration as to whether or not it is a high-risk intellectual property business and, if it is:
 - i. Detailed business plans which demonstrate the commercial rational for holding the intellectual property assets in Bahrain;
 - ii. Employee information, including level of experience, type of contracts, qualifications and duration of employment; and
 - iii. Evidence that decision making is taking place within Bahrain.
10. Details of any MNE Group in respect of which the relevant trader is a Constituent Entity. (MNE applies to Groups with a total consolidated revenue of at least EURO750 million).
11. Any other information as may be reasonably required by the Ministry. Relevant trader must provide the Ministry with such additional information (including a copy of a relevant book,

document or other record, or of electronically stored information) as shall be reasonably required by the Ministry in making a determination whether the relevant trader has passed or failed the ES Test. Such information shall be provided within a reasonable time specified by the Ministry.

A person who fails to provide or make certain information to the Authority without lawful excuse within the specified time or who knowingly or willfully alters, destroys, mutilates, defaces, hides or removes any such information may be criminally liable.

Sanctions

Based on article 9 of the MO 106, a trader, other than licensees which are covered by the CBB Directive, undertaking a relevant activity that:

- a) Fails to file an annual return; or
- b) Fails to meet the economic substance requirements for relevant activities i.e. does not demonstrate economic substance, will be deemed non-compliant and will be subject to sanctions.

Non-compliant traders may be subject to one or more of the following actions:

1. A warning notice
2. Suspension of CR
3. Striking off the trader from the CR
4. Financial penalties
5. Criminal prosecution

Factors that will dictate the type of sanctions imposed will depend on the type of breach, the number of times it has happened, and the MOICT's judgement. *Please note that this guideline is supported by:*

- 1. CIGA for relevant activities summary (Appendix 1)*
- 2. Economic substance return (Appendix 2)*
- 3. Frequently Asked Questions "FAQs" (Appendix 3)*
- 4. Economic Substance "ES" Chart (Appendix 4)*

Appendix 1 - CIGA for relevant activities summary

A core income generating activity¹ for a relevant activity:

A. Means an essential activity that is necessary to be carried out in order to produce the income from the relevant activity; and

B. In relation to each relevant activity in the first column of the table below, includes an activity specified in the second column of that table.

Relevant activity	Core income generating activities	Ministerial Order No. (106) of 2018 reference
Leasing	(a) identifying and acquiring assets to be leased; (b) setting the terms and duration of leasing; (b) monitoring and revising any agreements; or (d) managing any risks.	Article 3 (d)

¹ CIGAs conducted by licensees are covered by the CBB Directive and therefore not included here.

Distribution service centers	and (a) Transporting and storing goods, components and materials; (b) managing stocks; (c) taking orders; or (d) providing consulting or other administrative services.	Article 3 (a)
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Shipping	<p>(a) Managing crew (including hiring, paying and overseeing crew members);</p> <p>(b) overhauling and maintaining ships;</p> <p>(c) overseeing and tracking deliveries;</p> <p>(d) determining what goods to deliver and when to deliver them; or</p>	Article 3 (e)
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	(e) organizing and overseeing voyages.	
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Head office	<p>(a) Taking relevant management decisions;</p> <p>(b) incurring expenditures on behalf of group traders; or</p> <p>(c) coordinating group activities.</p>	Article 3 (b)
Holding companies	All activities associated with the income that holding companies earn such as interest, rent, and royalties.	Article 3 (c)
Intellectual property	<p>Intangible assets such as:</p> <p>(a) patents (research and development activities)</p> <p>(b) brands, trademarks, and customer data – branding, marketing and distribution activities;</p>	Article 3 (f)

	<p>The following activities (1) – (3) can qualify as CIGAs for Intellectual Property only in certain exceptional situations where a trader can prove that it is undertaking CIGAs associated with income from any intangible asset without specifically undertaking the main CIGAs:</p> <ol style="list-style-type: none">1. taking strategic decisions and managing (as well as bearing) the principal risks relating to the development and subsequent exploitation of the intangible asset;2. taking strategic decisions and managing (as well as bearing) the principal risks relating to the third-party acquisition and subsequent exploitation of the intangible asset;	
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	3. Carrying on the underlying trading activities through which the intangible assets are exploited, and which lead to the generation of revenue from third-parties.	
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Appendix 2 – Economic substance return

All traders that are carrying out any of the relevant activities mentioned in MO 106 will be required to complete the Economic Substance Return. Licensees which are covered by the CBB Directive are required to file a different return as specified by the CBB.

FORM 1
Kingdom of Bahrain
MINISTERIAL ORDER NO. 106 OF 2018 ("the MO")
(Article 8)

ECONOMIC SUBSTANCE RETURN

**attach additional pages and documents as necessary.*

1. Trader Name:

2. Trader CR no.:

3. Name of UBO/UPE/IPE:

4. Tax Residency of UBO/UPE/IPE:

5. Trader's Date of Incorporation, or First Registration under the MO:

6. Economic Substance Return Being Filed For the year (*Specify full date of year end, e.g. 31 December 2019*):

7. Please answer the following questions to ascertain the applicability of ES requirements:

NOTE: SUPPORTING DOCUMENTS MUST BE PROVIDED FOR ALL ANSWERS ON THIS RETURN.	
Part A: Applicability of ES requirements	
Q1: Does the trader conduct any relevant activity?	Yes/No
<i>If yes, please specify the relevant activity(s) and proceed to Q2.</i>	

If no, please skip Q2, Q3, Q4, and Parts B, C, D.

Q2: Does the trader have any overseas activities or does it conduct all of its activities only in Bahrain?

Please specify

A) Overseas only

B) Overseas and Bahrain

C) Bahrain only

In case the trader conducts overseas activities, please specify the overseas activity(s) and proceed to Part B.

In case the trader conducts all of its activities in Bahrain only, please proceed to Q3.

Q3: Does your trader constitute or form part of a Multi -National Entity?

Yes/No

If yes, please provide more details as annex about the name, address, activities, consolidated income, and distribution of shareholding and proceed to Part B.

If no, please proceed to Q4.

Q4: Does the trader only transacts with residents/customers in Bahrain?

Yes/No

If yes, please describe the relevant activities conducted, and how the trader verifies that it transacts with residents/customers in Bahrain. Then please skip Parts B, C, D.

If no, please proceed to Part B.

Part B: Pure equity holding	
Q1: Is the trader a pure equity holding?	Yes/No
<p><i>If yes, please answer Part C.</i></p> <p><i>If no, please go to Part D.</i></p>	

Part C: Economic Substance test for Pure equity holding traders	
Q1: Is your trader compliant with statutory filing requirements?	Yes/No
<p><i>Please explain your answer and provide supporting documents as annex to the ES return.</i></p>	
Q2: Are there adequate number of employees to perform the CIGA?	Yes/No
<p><i>If no, please justify</i></p> <p><i>If yes, please specify the number of employees and provide more details on why you think the number of employees is adequate.</i></p>	
Q3: Are there adequate premises in Bahrain?	Yes/No

If yes, please provide details on the number of premises and how are they adequate to perform CIGA.

If no, please justify

Q4: Does your trader perform any other relevant activity besides its pure holding? Yes/No

If yes, please specify the activity(s).

If no, please skip Part D.

Part D: Economic Substance test for all relevant activities

Relevant Activities test

Q1: How many relevant activities does the trader perform? Please specify

Please list the relevant activities.

Q2: Does the trader generate any income? Yes/No

Please specify the gross amount of income from related and non-related parties.

If no, please justify

Q3: Is the amount of income from the relevant activities?

Yes/No

If yes, please specify the amount of income from each relevant activity.

If no, please justify.

Q4: Does the trader have income from other activities?

Yes/No

Please specify the amount.

Management test

Q5: Are relevant activities of the trader directed and managed in Bahrain?

Yes/No

Please explain your answer and provide supporting documents as annex to the ES return.

Q6: Are there any meetings of Board of Directors, managers or partners held in Bahrain?

Yes/No

Please specify the number of meetings and provide supporting documents as annex.. If no, please justify

Q7: Are the meetings held in adequate frequencies given the level of decision making required?	Yes/No
<i>Please provide meeting agendas. If no, please justify</i>	
Q8: Is there quorum in Board of Directors, managers or partners meetings physically present in Bahrain?	Yes/No
<i>Please explain your answer and provide supporting documents as annex to the ES return.</i>	
Q9: Are there any minutes of meeting which reflect the strategic decisions of the trader, which must be set out at the Board of Directors, managers or partners meetings?	Yes/No
<i>Please provide minutes as annex. If no, please justify</i>	
Q10: Are all records of the trader (including minutes of meetings) readily available in Bahrain?	Yes/No

CIGA test	
Q11: Does the trader conduct their Core Income Generating Activities (CIGAs) in Bahrain?	Yes/No
<i>Please specify the activities.</i>	
Adequacy test	
Q12: Does the trader have an adequate level of qualified full-time employees resident in Bahrain, or adequate level of expenditure on outsourcing to third party service providers whose activities, employees, expenditure and premises are in Bahrain? If yes, are they proportionate to the activities?	Yes/No
<p><i>Please specify the number of qualified full-time employees and provide details on the qualifications of the employees. Furthermore, if the trader is conducting more than one relevant activity, please submit a breakdown of employees (and operating expenditures) per activity.</i></p> <p><i>In case of outsourcing, please name the third party and specify the amount of expenditure. If no, please justify</i></p>	
Q13: Does the trader have an adequate level of annual operating expenditure in Bahrain?	Yes/No

If yes, please specify the amount of operating expenses and provide more details on the type of expenses, amounts, and why do you think the level of expenditure is adequate. If no, please justify

Q14: Does the trader have adequate physical offices and/or premises in Bahrain, or adequate level of expenditure on outsourcing to third party service providers in Bahrain?

Yes/No

Please provide more details about the number of offices in Bahrain or amount of expenditure in case of outsourcing.

If no, please justify

Q15: Does the trader establishes an adequate set of internal policies and controls for its operation, compliance, corporate governance and risk

Yes/No

management? If yes, are those policies regularly reviewed to ensure that they remain appropriate, relevant and prudent?

If no, please justify

Q16: Does the trader maintain adequate and proper records and books of accounts in Bahrain? If yes, do these records and books of accounts meet the International Financial Reporting Standards (IFRS)?

Yes/No

<i>If no, please justify</i>	
Q17: Do these records and books of accounts contain type of business?	Yes/No
<i>If no, please justify</i>	
Q18: Do these records and books of accounts contain amount and type of gross income?	Yes/No
<i>If no, please justify</i>	
Q19: Do these records and books of accounts contain amount and type of expenses and assets?	Yes/No
<i>If no, please justify</i>	

<i>Other Economic Substance requirements</i>	
Q20: Does the trader clearly indicate its name and commercial registration number on its letterhead, stationery and other documents, websites and social media platforms?	Yes/No

<i>If no, please justify</i>	
Q21: Does the trader obtain the prior approval of the Ministry for the establishment of an office outside Bahrain?	Yes/No
<i>Please specify if this question is not applicable to you. If no, please justify</i>	
Q22: Does the trader obtain the prior approval of the Ministry for change of shareholders?	Yes/No
<i>If no, please justify</i>	
Q23: Does the trader obtain the prior approval of the Ministry for appointment of directors?	Yes/No
<i>If no, please justify</i>	

Outsourcing test

Q24: Does the trader outsource any of its relevant activities to third party service providers?	Yes/No
<p>If no, skip Q26-29.</p> <p>If yes, please provide more details about the activity being outsourced, e.g. (type of outsourced activity, service provider name and address, and amount of expenditure)</p>	
Q25: Is the outsourced activity conducted in Bahrain?	Yes/No
<p><i>Please explain your answer and provide supporting documents as annex to the ES return.</i></p>	
Q26: Does your service provider dedicate enough resources exclusively to the outsourced activity?	Yes/No
<p><i>Please explain your answer and provide supporting documents as annex to the ES return.</i></p>	
Q27: Do you ensure that those exclusive resources are not double counted toward services provided to other traders?	Yes/No

Please explain your answer and provide supporting documents as annex to the ES return.

Q28: Are you able to demonstrate adequate supervision of the outsourced activity?

Yes/No

Please explain your answer indicating the actions taken by your trader in this respect and provide supporting documents as annex to the ES return.

Intellectual Property

Q29: Does the trader conduct an intellectual property activity?

Yes/No

If no, please skip Q30.

If yes, please provide more details about the nature of the IP activity.

Q30: Is the trader a high-risk intellectual property trader?

Yes/No

If yes, please provide the following as annex:

- (i) Detailed business plans which demonstrate the commercial rational for holding the intellectual property assets in Bahrain
- (ii) Employee information, including level of experience, type of contracts, qualifications and duration of employment; and
- (iii) Evidence that decision making is taking place within Bahrain

8. Certified correct and submitted by:

Name:

Signature:

Office Held:

Date:

FOR MINISTRY USE ONLY

Trader CR:

Staff Name:

Date Filed:

Received By: