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REGIONAL DEVELOPMENTS

Saudi Arabia*

King Fahd bin Abdul Aziz has issued royal decrees appointing the members of the heralded Consultative Council and the various provincial councils, promulgating the bylaws for the Consultative Council, and amending the law governing the Council of Ministers. The government has issued a ministerial resolution providing under certain circumstances for an additional tax holiday to foreign investors in the event an existing equity joint venture in the industrial sector expands its production facilities. The government has also issued rules governing the establishment and operation of mutual funds by local banks in Saudi Arabia, and expanded the commercial agencies law to cover franchise agreements. New antibribery regulations have been enacted to stiffen penalties against bribery.

I. Further Structural Developments

In August 1993 King Fahd bin Abdul Aziz appointed the sixty members of Saudi Arabia's first Consultative Council (*majlis al shoura*),[1] which was established pursuant to the new consultative council law.[2] Simultaneously,

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1. Royal Decree No. A/16 dated 3/3/1414 A.H. (corresponding to August 20, 1993), published in *Umm Al Qura*, issue no. 3468, dated 10/3/1414 A.H. (corresponding to August 27, 1993). The appointments became effective upon issuance of the Royal Decree.

2. Royal Decree No. A/91 dated 27/8/1412 A.H. (corresponding to March 1, 1992), published in *Umm Al Qura*, issue no. 3397, dated 2/9/1412 A.H. (corresponding to March 6, 1992) [hereinafter Consultative Council Law]. The Consultative Council Law became effective six months after its publication. *See also Regional Developments: Saudi Arabia*, 26 INT'L LAW. 822, 830-31 (1992).

the King announced the bylaws for the Consultative Council[3] and promulgated new rules governing the Council of Ministers.[4] In September 1993 King Fahd announced the establishment of thirteen provincial councils[5] pursuant to the new provincial government law[6] and appointed the 210 members of the provincial councils.[7]

The Consultative Council Bylaws are divided into six sections that set forth a framework for the functioning of the Council. Such bylaws require the Council to hold ordinary sessions at least once every two weeks.[8] Two-thirds of the members constitute a quorum for meetings, the affirmative vote of a majority of the members is required for action, and the Council president has a casting vote.[9] A general committee composed of the Council president and vice president, and the chairmen of special committees that may be established by the Council to study particular issues, prepares agendas for meetings.[10] Members may address Council sessions provided that they submit written requests to the Council president.[11] The Council president has broad powers to convene and chair Council sessions, issue rules for regulating Council administrative and financial business, and prepare an annual report regarding Council activities.[12]

The Council of Ministers is the executive body in Saudi Arabia. It is composed of the prime minister (a post now held by King Fahd), the prime minister's deputies, ministers of state and the King's advisors.[13] The King issues legislation in Saudia Arabia by royal decree at the recommendation of the Council of Minis-

3. Royal Decree No. A/15 dated 3/3/1414 A.H. (corresponding to August 20, 1993), published in *Umm Al Qura*, issue no. 3468, dated 10/3/1414 A.H. (corresponding to August 27, 1993) [hereinafter Consultative Council Bylaws].

4. Royal Decree [-] dated 3/3/1414 A.H. (corresponding to August 20, 1993), published in *Umm Al Qura*, issue no. 3468, dated 10/3/1414 A.H. (corresponding to August 27, 1993) [hereinafter Council of Ministers Law]. The official gazette did not indicate the number of the decree.

5. Royal Decree No. A/20 dated 30/3/1414 A.H. (corresponding to September 16, 1993), published in *Umm Al Qura*, issue no. 3472, dated 8/4/1414 A.H. (corresponding to September 24, 1993).

6. Royal Decree No. A/92 dated 27/8/1412 A.H. (corresponding to March 1, 1992), published in *Umm Al Qura*, issue No. 3397, dated 2/9/1412 A.H. (corresponding to March 6, 1992) [hereinafter Provincial Government Law]. The Provincial Government Law became effective one year after its publication. In addition, certain minor corrections were made to the Provincial Government Law pursuant to Royal Decree No. A/21 dated 30/3/1414 A.H. (corresponding to September 16, 1993), published in *Umm Al Qura*, issue no. 3472, dated 8/4/1414 A.H. (corresponding to September 24, 1993).

7. Royal Decree No. 8/284 dated 3/4/1414 A.H. (corresponding to September 19, 1993), published in *Umm Al Qura*, issue no. 3472, dated 8/4/1414 A.H. (corresponding to September 24, 1993). The appointments became effective upon issuance of the Royal Decree.

8. Consultative Council Bylaws, *supra* note 3, art. 12.

9. *Id.* arts. 31, 32; Consultative Council Law, *supra* note 2, art. 16.

10. Consultative Council Bylaws, *supra* note 3, arts. 8, 11.

11. *Id.* art. 15.

12. *Id.* arts. 1-4, 33-34.

13. Council of Ministers Law, *supra* note 4, art. 12.

ters. Prior to the establishment of the Consultative Council, the Council of Ministers had sole authority to determine state policy, including all executive, administrative, and regulatory authority.[14] The Council of Ministers Law supersedes the prior law governing the Council of Ministers in certain important respects. The new law reflects the creation of the new Consultative Council. While all cabinet decisions remain subject to the approval of the King, the new law creates a mechanism to expand debate on important issues by enabling the Council of Ministers to review and present to the King the decisions of the Consultative Council on such issues.[15] In addition, the Council of Ministers Law provides that each council will be appointed for a term not to exceed four years.[16] Previously no term limits had been set, and ministers frequently remained in office for many years.

II. Foreign Capital Investment Tax Holiday

Foreign capital investment in Saudi Arabia is subject to prior licensing by the Ministry of Industry and Electricity.[17] One of the major incentives to foreign investment has been the availability in certain circumstances of a tax holiday for the foreign investor. Provided the Saudi investor owns at least 25 percent of the licensed company's share capital,[18] the law exempts the foreign investor from paying Saudi corporate income tax[19] for a period of ten years in the case of an industrial project or an agricultural project and five years as to all other licensed projects.[20] The exemption with respect to an industrial or an agricultural project commences from the starting date of production, and from the date of commercial registration as to other projects.[21] It was previously not possible to obtain further

14. *See* Royal Decree No. 38 dated 22/10/1377 A.H. (corresponding to May 11, 1958), published in *Umm Al Qura*, issue no. 1717, dated 27/10/1377 A.H. (corresponding to May 16, 1958), art. 18 [hereinafter Royal Decree No. 38].

15. *See* Council of Ministers Law, *supra* note 4, arts. 19-20, and Consultative Council Law, *supra* note 2, art. 17; *compare* Royal Decree No. 38, *supra* note 14, art. 18.

16. Council of Ministers Law, *supra* note 4, art. 9.

17. *See* Royal Decree No. M/4 dated 2/2/1399 A.H. (corresponding to January 1, 1979) [hereinafter Investment Code], and Ministry of Industry and Electricity Resolution No. 323 dated 10/6/1399 A.H. (corresponding to May 7, 1979) [hereinafter Investment Code Rules].

18. Investment Code, *supra* note 17, art. 7(b). The Investment Code permits direct foreign investment in Saudi limited liability companies and in joint stock companies, although such investment in joint stock companies is rare.

19. The tax rates are 25% on the first SR 100,000 of annual taxable income; 35% on the next SR 400,000; 40% on the next SR 500,000; and 45% on the annual taxable income in excess of SR 1,000,000. *See* Royal Decree No. 17/2/28/3321 dated 21/1/1370 A.H. (corresponding to November 1, 1950) as amended, art. 11 [hereinafter Income Tax Law].

20. Investment Code, *supra* note 17, art. 7(b). A year is computed according to the Hejira calendar year, which is eleven days shorter than a year based on the Gregorian calendar.

21. Investment Code Rules, *supra* note 17, art. 18. Although the ten-year holiday is technically applicable to agricultural projects, for some time there has been a moratorium on the approval of such projects for licensing by the Foreign Capital Investment Committee, which administers the investment licensing regime.

extension of the tax holiday in any circumstances,[22] and it was generally not possible for foreign investors to obtain tax exempt licensing for new equity joint ventures involving activities similar to those for which such investors had previously been licensed.[23]

In May 1993, pursuant to his powers under the Income Tax Law,[24] the Minister of Finance and National Economy issued a resolution providing that if an industrial company licensed under the Investment Code increases its authorized share capital for the purpose of expanding its production facilities, under certain circumstances a separate ten-year tax holiday will be granted with respect to the company's taxable profits derived from such expansion.[25] The increase of share capital can be either by injection of new funds or by capitalization of retained earnings or nonstatutory reserves.[26] The expansion can either increase the plant's existing production capacity or enable it to manufacture other products.[27] The stated objective of Resolution 3/3170 is to promote Saudi Arabia's policy of increasing foreign investment in domestic joint ventures and encouraging foreign partners to participate in expansion of existing joint ventures by new capital contributions, which will in turn enhance technology transfer in the industrial sector.

Resolution 3/3170 enumerates the conditions that must be satisfied to qualify for the tax exemption. These include due licensing of the expansion under the Investment Code,[28] Saudi shareholding of not less than 25 percent of the total capital,[29] the taking of all requisite corporate action to authorize and to effect the capital increase,[30] certification by the Saudi Industrial Development Fund and commercial banks as to any loans provided for the expansion,[31] and regular tax and audit compliance by the joint venture company.[32]

The tax exemption under Resolution 3/3170 is not automatic. The joint venture company must make a filing with the Department of Zakat and Income Tax (DZIT) within thirty days of the issuance of the requisite industrial license by the Ministry of Industry and Electricity for the new expansion, and must subsequently file an application for the exemption when the expansion work com-

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22. However, some very rare exceptions do exist. For example, the foreign investor in an industrial company that established a second manufacturing facility in a different city from that where the first facility was located, and while its tax holiday was still in effect, is understood to have enjoyed a further ten-year holiday in relation to its taxable income derived from the second facility.
23. *See* Investment Code Rules, *supra* note 17, art. 21.
24. Income Tax Law, *supra* note 19, art. 19.
25. Ministry of Finance and National Economy Resolution No. 3/3170 dated 2/12/1413 A.H. (corresponding to May 23, 1993) [hereinafter Resolution 3/3170].
26. *Id.* art. *first.*
27. *Id.* art. *first*, para. 4.
28. *Id.* art. *first*, paras. 1-2.
29. Id. art. *first*, para. 6.
30. Id. art. *first*, para. 3.
31. Id. art. *first*, para. 5.
32. Id. art. *first*, paras. 7, 9.

mences.[33] The ten-year holiday with respect to the profits derived from the expansion commences from the start of production by the new facilities.[34]

Resolution 3/3170 is ambiguous in certain important respects. For example, the formula for computing tax-exempt profit is unclear. One provision of the resolution indicates that the nontaxable profit will be computed as a percentage of total profit in the same ratio as new share capital to total share capital.[35] Other provisions indicate that separate audited income statements must be maintained for the existing and new operations[36] and that only those profits derived from operation of the new facilities will be tax exempt.[37] Efforts on the part of local tax practitioners to resolve such ambiguities with the DZIT have been slow to produce results. Resolution 3/3170 provides that the DZIT will issue forms and declarations for implementation of the exemption.[38] However such forms and declarations have not yet been released to the public.

Notwithstanding its ambiguities, which will undoubtedly be resolved over time as the DZIT develops its procedures and practice in these regards, it is clear that Resolution 3/3170 is limited in scope to profits derived from an increase in authorized share capital of an existing industrial company that expands its licensed production facilities and will not extend or otherwise affect investment tax holidays in any other circumstances.

III. Rules Governing Saudi Mutual Funds

In January 1993, pursuant to his powers under the Banking Control Law,[39] the Minister of Finance and National Economy issued new rules regulating the establishment and operation by Saudi Arabian banks of mutual or investment funds in Saudi Arabia.[40] The Mutual Fund Rules require that local banks seeking to launch mutual funds establish a separate investment services department for the management and operation of such funds independent from the management of the bank's investments.[41] The establishment of each mutual fund is subject to prior approval of the Saudi Arabian Monetary Agency (SAMA), Saudi Arabia's central bank, which drafted the rules.[42] The application to SAMA for such approval should include copies of the proposed terms and conditions of the agreement governing the relationship between the bank and investors, the prospec-

33. Id. art. *first*, para. 10.
34. Id. art. *third*.
35. *Id.* art. *fourth*.
36. *Id.* art. *first*, para. 9.
37. Id. art. *fifth*.
38. *Id.* art. *sixth*.
39. Royal Decree No. M/5 dated 22/2/1386 A.H. (corresponding to June 11, 1966), art. 16(3).
40. Ministry of Finance and National Economy Resolution No. 3/2052 dated 24/7/1413 A.H. (corresponding to January 17, 1993) [hereinafter Mutual Fund Rules].
41. *Id.* art. *second*, para. 2.
42. *Id.* art. *first*, para. (a); art. *third*, para. 3.

tus and other publicity material, and any agreement relating to custody of fund assets.[43]

The Mutual Fund Rules specify the minimum information that should be contained in the agreement between the offering bank and the fund investors. This information should include the type of investors targeted; investment objectives and policies; investment risk; minimum subscription; the minimum amount necessary for the operation of the fund; subscriptions days; redemption period; valuation method and timing; management fees and expenses; redemption procedures; procedures for liquidating the fund; and information concerning the fund's manager, advisor, custodian, and auditor.[44]

The Mutual Fund Rules require banks to comply with various accounting and reporting requirements. Banks must provide investors and SAMA with unaudited semiannual financial statements and audited annual financial statements.[45] Investors should also receive quarterly account statements indicating the number of fund units held, the valuation thereof, and any commissions or other fees paid.[46]

The Mutual Fund Rules specify certain operating requirements for funds, including methods for holding fund assets, liquidity requirements, permissible fund currencies, permissible fees and expenses, and methods of pricing fund units. The Mutual Fund Rules also stipulate certain restrictions on transactions by the fund manager and its employees, such as insider trading, the provision of brokerage services, and the acquisition by a fund of securities or credit from the bank offering the fund.[47]

The Mutual Fund Rules do not address the marketing and distribution of foreign mutual funds to investors in Saudi Arabia. The offer of foreign mutual funds for subscription or sale in Saudi Arabia would appear to require the prior approval of the Minister of Commerce.[48]

IV. Franchise Agreements

No natural or corporate person may act as a commercial agent in Saudi Arabia unless such person is a Saudi national or, in the event of a corporate person, is directly owned by wholly Saudi interests in which all of its directors, managers,

43. Id. art. *third*, para. 3.
44. *Id.* art. *third*, paras. 3, 4.
45. *Id.* art. *fifth*, paras. (b)(2), (3).
46. *Id.* art. *fifth*, para. (b)(4).
47. *Id.* art. *fourth*, paras. (j), (k)(1), (3).
48. *See* Regulations for Companies issued under Royal Decree No. M/6 dated 22/3/1385 A.H. (corresponding to July 20, 1965) as amended, art. 228: "Foreign companies may not . . . issue securities or offer them for subscription or sale within the Kingdom except with permission from the Minister of Commerce. . . ." The term "securities" is not defined, but would appear to encompass shares or units in closed-end or open-end funds.

or other officers authorized to bind the entity, are Saudi nationals.[49] The term "commercial agent" is defined to include commission agents and distributors.[50] Commercial agents and distributors must be duly registered in the commercial register, a department of the Ministry of Commerce. The agent or distributor is also required to submit to the Ministry of Commerce for registration each commercial agency or distributorship agreement to which it becomes a party. Failure to register with the Ministry of Commerce could result in imposition of fines and other penalties on the Saudi agent or distributor, but such failure would not void the agency or distributorship agreement, nor would it subject the foreign principal or vendor to any penalties. In March 1993 the Minister of Commerce extended the applicability of the Commercial Agencies Regulations and Commercial Agencies Rules to franchise agreements.[51] Saudi franchisees were afforded six months within which to apply for registration of existing franchise agreements.[52]

V. Antibribery Regulations

In August 1992 new antibribery regulations came into force.[53] Like the prior law,[54] the New Antibribery Law provides for sanctions against civil servants accepting bribes and against bribers and their accomplices.[55] Such sanctions vary depending on the type of offense, but generally entail dismissal and banning from public employment for the civil servant,[56] and fines, or imprisonment, or both.[57] Under the Old Antibribery Law fines ranged from SR 5,000 to SR 100,000, and imprisonment ranged from one to five years. Under the New Antibribery Law

49. Royal Decree No. M/11 dated 20/2/1382 A.H. (corresponding to July 22, 1962), art. 1 [hereinafter Commercial Agencies Regulations.]; *see also* Ministry of Commerce Resolution No. 1897 dated 24/5/1401 A.H. (corresponding to March 30, 1981) [hereinafter Commercial Agencies Rules].

50. Commercial Agencies Regulations, *supra* note 49, as amended by Royal Decree No. M/32 dated 10/8/1400 A.H. (corresponding to June 23, 1980), para. *second*, art. 1; *see also* Commercial Agencies Rules, *supra* note 49, art. 1.

51. Ministry of Commerce Resolution No. 1012 dated 27/9/1412 A.H. (corresponding to March 31, 1992), art. 1, published in *Umm Al Qura*, issue no. 3402, dated 21/10/1412 A.H. (corresponding to April 24, 1992).

52. *Id.* art. 2.

53. Council of Ministers Resolution No. 175 dated 28/12/1412 A.H. (corresponding to June 28, 1992), published in *Umm Al Qura*, issue no. 3414, dated 2/2/1413 A.H. (corresponding to July 31, 1992) [hereinafter New Antibribery Law]. The New Antibribery Law became effective 30 days after publication.

54. Royal Decree No. 15 dated 7/3/1382 A.H. (corresponding to August 7, 1962) [hereinafter Old Antibribery Law].

55. *See* New Antibribery Law, *supra* note 53, arts. 1-11, 13; *compare* Old Antibribery Law, *supra* note 54, arts. 1-10, 12.

56. New Antibribery Law, *supra* note 53, art. 13; *compare* Old Antibribery Law, *supra* note 54, art. 12.

57. New Antibribery Law, *supra* note 53, arts. 1-7, 9-11; *compare* Old Antibribery Law, *supra* note 54, arts. 1-8, 10.