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Qualification, Licensing and Registration of Foreign Companies in Saudi Arabia

When a foreign company or partnership elects to commence activity in Saudi Arabia, it may utilize a variety of methods. It may designate a local agent to act on its behalf and employ its people. It may organize a company or partnership under the laws of Saudi Arabia, either alone or jointly with a Saudi investor. Or it may seek to obtain a license for its activities in Saudi Arabia without forming any new legal entity. The structure which it elects to use will be dependent on a variety of considerations, including: the nature of the business to be conducted, the availability of a satisfactory local partner, the need for a limitation on liability, and the need for a tax holiday. This paper explores in general the considerations involved in deciding what legal form should be used by a foreign company for its operations in Saudi Arabia.

I. Legal Considerations

The legal considerations relating to the ability of a foreign company to do business in Saudi Arabia, include the following:

- a. *Regulations for Companies.* The basic limitation on foreign activity in Saudi Arabia is set forth in Article 228 of the Regulations for Companies:

Foreign companies may not establish branches, agencies, or offices to represent them . . . except with permission from the Ministry of Commerce. These branches, agencies, or offices shall be subject to the Regulations in force within the Kingdom applicable to the particular activity in which they engage.

If such branch, agency or office conducts business before fulfilling the requirements specified in these and other Regulations, the persons who have conducted such business shall be held personally and jointly responsible therefor.

- b. *Foreign Capital Investment Regulations.* The Foreign Capital Investments Regulation appears to apply in all situations where foreign

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entities invest capital in projects in Saudi Arabia including those where the investment takes the form of equipment, spare parts, raw materials, products, transportation facilities or intangible rights. Application for a license to invest must be made to the Committee for Foreign Capital Investments unless "the project is authorized to operate in the Kingdom by virtue of a special agreement." In order to qualify for a license it must be shown that the capital is to be invested in an economic development project.

c. *Tenders Regulations.* Article 32 of the Tenders Regulations requires that:

A bidder must either be a resident in the Kingdom or have a (resident) agent therein. Otherwise he must state in his bid the (name and) address of his authorized agent in the Kingdom, so that the latter may be contacted if the contract is awarded to such bidder.

A subsequent interpretation of this provision by the Ministry of Finance has indicated, however, that:

. . . The Tenders Regulations do not stipulate that a bidder residing abroad should have a commercial agent. It will suffice if he provides a name and an address to which correspondence relating to the bid will be sent.

d. *Regulations for Commercial Agencies.* Article 1 of the Commercial Agencies Regulations provides that:

Non-Saudis, whether in their capacity as natural or juristic persons, shall not be permitted to act as commercial agents in Saudi Arabia, and Saudi companies acting as commercial agents shall have completely Saudi capital and their directors and those authorized to sign for them shall be Saudis.

To act as a commercial agent means basically to engage in the sale of goods within Saudi Arabia, which would include the sale of any goods imported into Saudi Arabia. In a memorandum dated December 8, 1976, the Minister of the Interior reiterated this ban on foreigners acting as local merchants. This restriction does not relate to the sale of services.

e. *Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis.* Section 2 of the Real Estate Ownership Regulations provides that:

A non-Saudi shall not be allowed by any means other than inheritance to acquire the right of ownership or any other corporeal and original right with regard to real estate located within the Kingdom of Saudi Arabia . . .

There are certain exceptions relating to diplomatic missions, agricultural use, land required by projects receiving foreign capital investment licenses and by royal decree.

f. *Residence Regulations.* One of the conditions required of a foreign person obtaining a Saudi Arabian residence permit is that:

He shall hold a contract with a company, a registered commercial firm or a known businessman in the country.

In this connection, Article 26 of the Residence Regulations provides that:

[a]ll companies, commercial and business firms, merchants, contractors and the like are forbidden to employ any foreigner unless he holds a residence permit or an endorsed work permit.

- g. *Commercial Registration.* Every industrial or commercial establishment, whether Saudi or non-Saudi, is required to be registered, under the Commercial Registration Regulations, with the office of the Commercial Register in the province where such establishment is operating. In this connection, Article 4 of the Commercial Registration Regulations provides that:

All persons responsible for the administration of branches or agencies of foreign companies with headquarters abroad, are required to submit applications for registration of the said branches or agencies within the period of one month from the date of their opening.

II. Methods of Operation

Based in part on the foregoing legal restrictions and in part on certain practical considerations, the following alternatives are available for the foreign company wishing to operate legally in Saudi Arabia.

- a. *Agency Agreement.* This structure is purely contractual. What is involved is an agreement between a foreign company and a Saudi entity pursuant to which the Saudi entity agrees to act for the foreign company in Saudi Arabia. Such action may take the form of distribution of the foreign company's products, the provision of after sales service, or sponsorship of the foreign employees. This form is often used by foreign companies wishing to sell their goods in Saudi Arabia. In this situation, since the goods are usually sold to the agent for distribution and such sale is effective before the goods are brought into Saudi Arabia, there is no Saudi income tax payable by the foreign company.

In the situation where the foreign company is selling services within Saudi Arabia, through employees who are sponsored by the Saudi agent, the situation is different. Here, the compensation to the foreign company for the local services performed by its sponsored employees will be subject to Saudi income tax. In this connection, Article 13 of the Income Tax Regulations provides that:

There shall be considered as gross income for any company incorporated under the laws of any country other than Saudi Arabia, and carrying on its operations at the same time both outside and inside the Kingdom of Saudi Arabia, all the proceeds which that company earns locally from any source within the Kingdom.

The agency arrangement is also not particularly desirable for foreign companies providing services under the sponsorship format because their employees are essentially operating at the sufferance of the Saudi agent,

since they are technically the latter's employees. In other words, the presence of the foreign company's personnel in Saudi Arabia is entirely dependent on the continued existence of the relationship with the Saudi agent.

As a procedural matter, the only step which needs to be taken if an agency agreement is used, is that the agreement must be registered with the Ministry of Commerce.

- b. *The Temporary License.* A temporary license will be granted to a foreign company where it enters into a contract to provide goods or services to an agency of the government. In effect, the governmental agency acts as the sponsor for the foreign company and its employees in connection with the performance of the contract. This type of license expires when the contract is completed, unless additional work is obtained from the same, or another governmental agency. Personnel and equipment of the foreign company assigned to the contract are not permitted to perform work for other private customers while operating under such a temporary license, although as a practical matter, they often do business for such customers during the term of the license.

Any profits from the performance of the contract, and any profits derived from other activities within Saudi Arabia during such period, are subject to Saudi corporate income tax, although foreign companies are sometimes able to negotiate a tax reimbursement provision with the governmental agency for which the contract is being performed.

The entity which would obtain the foreign investment license could take either of two forms: (1) a subsidiary or partnership organized under the laws of Saudi Arabia which was wholly owned by the foreign company; or (2) a company or partnership organized under the laws of Saudi Arabia, in which a portion of the ownership, or at least some of the partners would be Saudi individuals or legal entities.

1. *Legal Entity Organized Under the Laws of Saudi Arabia.* The Regulations for Companies contain provisions for a variety of legal structures ranging from a general partnership to a limited partnership to a limited liability partnership to, finally, a joint stock company. All of the structures except the limited liability partnership and the joint stock company subject at least some of the investors to unlimited liability. Formation of a joint stock company requires a royal decree. Therefore, the most commonly used, and recommended, structure is the limited liability partnership (or limited liability company, as it is often called). The main limitations on the use of this structure are that it cannot be used for insurance, savings or banking operations and that it must have at least two and not more than fifty shareholders.

As noted above, the legal entity organized under the laws of Saudi Arabia may be either wholly or partially owned by the foreign company. For the purposes of subsequent discussion, it is assumed that a limited liability company will be used. From a procedural standpoint, exactly the same steps are required for the formation and qualification of either type of entity. These steps, which will be described below, include: obtaining a license from the Committee for Foreign Capital Investment, approval of the Articles of Association by the Ministry of Commerce, recordation of the Articles before a Notary Public, publication of the Articles, and registration of the company in the Commercial Register. Significantly different results, however, follow from whether the ownership by the foreign company is partial or total. It should be noted that if the new Saudi entity is to engage in certain special kinds of activities, such as transportation, these are additional requirements which must also be satisfied. A description of such additional requirements is beyond the scope of this article.

- a. *The Wholly Owned Limited Liability Company.* It is theoretically possible to have a limited liability company organized under the laws of Saudi Arabia all of whose capital stock is owned or controlled by a foreign company. However, this structure is not, as a practical matter, used. There are three reasons for this. First, most foreign companies find that it is difficult and inadvisable to operate without a Saudi partner. Second, most foreign companies would like to have the benefit of the five year tax holiday, which is only available if they have a Saudi partner who owns at least a 25 percent interest in the Saudi company. Third, it has been the experience of many, that the Committee for Foreign Capital Investment will not approve a license for a limited liability company in which there is no Saudi interest.
- b. *The Partially Owned Limited Liability Company.* As noted above, the main virtues of a limited liability company with a partial Saudi ownership are the involvement of a Saudi partner and the consequently greater level of local assistance, the eligibility for a five year tax holiday, and the greater likelihood that the license from the Committee for Foreign Capital Investment will be granted.

The main problem with such a structure, is the desire to avoid having to split revenues with a local partner. Beyond this, there is also the practical concern that the selection of one Saudi partner may restrict the foreign company from establishing business relationships with other Saudi individuals or companies.

Although not entirely responsive to these concerns, it should be noted that the articles of association of the limited liability company can be

drafted to give a large measure of control to the foreign company. What is often done is to have a management contract between the foreign company and the Saudi limited liability company which gives the foreign company basic responsibility for operations. With respect to the split of profits from the limited liability company, it should also be noted that the profit distributions need not coincide with the percentages of stock ownership. Therefore, it would be possible to have a Saudi partner who would receive only a small percentage of the operating profits of the company even though his stock ownership in the company was substantial.

2. *Procedures Required.* The procedures required for qualification, licensing and registration of a limited liability company are as follows:

- a. Submission of an application to the Committee for Foreign Capital Investment. The application consists of:
 - (i) A completed application form for a service company which is provided by the Committee;
 - (ii) A feasibility study;
 - (iii) Draft articles of association;
 - (iv) The charter and bylaws of the foreign company;
 - (v) Resolutions by the foreign company approving participation in the joint company, and authorizing individuals in Saudi Arabia to act on behalf of the foreign company in connection with the qualification, licensing and registration of the new company;
 - (vi) A power of attorney from the foreign company to a local Saudi representative, usually a lawyer, to act in connection with the qualification, licensing and registration;
 - (vii) An undertaking from the foreign company with respect to the training of local personnel;
 - (viii) The financial statements of the foreign company for the previous three years;
 - (ix) Brochures describing the business of the foreign company.

Items [iv], [v] and [vi] should be legalized by the Saudi Consulate in the jurisdiction where the foreign company is organized. Items [i] through [vii] should be translated into Arabic.
- b. After the Foreign Capital Investment License has been received (about six to eight weeks) the draft articles should be sent to the Ministry of Commerce for clearance.
- c. After clearance the articles should be transcribed before the Notary Public in the province where the main office of the new company is located, and then signed by the partners or persons holding their powers of attorney.

- d. After transcription before the Notary Public the articles should be published in the Official Gazette.
- e. Following publication, the capital of the new company should be deposited with a local bank, and two applications should be made for registration of the new company in the register of companies and in the commercial register in the province where the main office of the company is to be located.

III. Conclusion

If the foreign company's interest in operating in Saudi Arabia without a Saudi partner is paramount, and the foreign company wishes to be available for non-governmental work, then the procedures set forth above are less than satisfactory. This is mainly because a project which involves a Saudi limited liability company with no Saudi ownership runs a greater risk of not obtaining a foreign investment license than a project in which there is a Saudi interest.

If a Saudi interest is contemplated, then the limited liability company format with a Foreign Capital Investment License is the recommended procedure.

Regardless of the type of license obtained or even if no license is obtained, any foreign company operating in Saudi Arabia will be subject to the various regulations relating to such things as labor, social security, and income tax, unless they are specifically exempted.

