

# Legal Aspects of Doing Business in Saudi Arabia

## I. Introduction

Saudi law is composed of two sources: the *Sharia*, which is based on Islam, and civil law, which is composed of regulations promulgated by royal decree, ministerial decisions and administrative circulars. The *Sharia* is the ultimate yardstick against which both the personal and commercial conduct of affairs in Saudi Arabia are judged. The *Sharia* is embodied in the Koran and other religious sources and deals mostly with personal, family and criminal matters. The other source of law in Saudi Arabia—secular or civil law—generally regulates the commercial day-to-day transactions in Saudi Arabia.<sup>1</sup>

A basic difference between Saudi law and American law is that judicial precedent is not very important in Saudi Arabia. A judge need not follow either his own prior decisions or those of higher courts.<sup>2</sup> Judicial decisions are generally not recorded in writing. In the few instances where these decisions are written down, they are unevenly distributed and may appear only in summary form.

## II. Business Entities for Foreigners in Saudi Arabia

### A. *Permanent Establishments*

The Saudi Companies Regulations<sup>3</sup> set forth the basic rules regarding the organization of a business in Saudi Arabia. The Companies Regulations

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<sup>1</sup>The present civil regulatory structure in Saudi Arabia has its origins in the first Saudi Commercial Code promulgated by King Abdul Aziz in 1931. ROYAL DECREE NO. 32 of 15.1.1350 A.H. (A.D. 1931).

<sup>2</sup>Shamma, *Law and Lawyers in Saudi Arabia*, 14 INT'L & COMP. L.Q. 1034, 1035 (1965).

<sup>3</sup>ROYAL DECREE NO. M/6 of 17.3.1385 A.H. (1965).

contain eight forms of business association.<sup>4</sup> Six of these forms are not fully limited liability companies. The other two forms are the joint stock company and the limited liability company. The latter is preferred by foreign companies doing business in Saudi Arabia, since the joint stock company can only be incorporated by royal decree and must have at least five shareholders.<sup>5</sup> A limited liability company must have at least two shareholders but no more than fifty.<sup>6</sup> The minimum capital is approximately \$15,000,<sup>7</sup> which must be divided into shares of equal value. Shares in a limited liability company confer equal rights to net profit participation, unless the company's articles specify otherwise.

Foreign companies wishing to invest in a company in Saudi Arabia must obtain a Foreign Capital Investment License (FCIL) under the Foreign Capital Investment Code<sup>8</sup> from the Ministry of Industry and Electricity. While this Code theoretically allows for the granting of FCILs to 100 percent foreign-owned companies, in practice this rarely occurs. Non-Saudi companies wishing to do business in Saudi Arabia prefer a joint venture limited liability company, in which a Saudi owns at least 25 percent.

In order to obtain the FCIL, the foreign investor must submit an application to the Foreign Capital Investment Committee (FCIC) of the Ministry of Industry and Electricity. This application usually consists of a standard form issued by the Ministry of Industry and Electricity together with a feasibility study. The FCIC reviews investment applications, and recommends to the Ministry of Industry and Electricity whether or not to grant the FCIL.

The FCIC will only grant licenses to foreign investors if the proposed venture qualifies as an "economic development project," and involves the transfer of foreign technology to the kingdom.<sup>9</sup> The basic criteria to qualify as an economic development project includes whether the venture will employ and train Saudi nationals, the type and availability of the relevant technology in Saudi Arabia, and whether the venture will expand manufacturing capabilities in Saudi Arabia. The Ministry of Industry and Electricity usually grants only a limited number of licenses for each type of undertaking. There are five types of economic development projects—industrial, agricultural, health development, services and contracting projects.<sup>10</sup> Industrial projects are defined as projects which "process raw materials into fully or semi-manufactured goods or process semi-manufac-

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<sup>4</sup>*Id.* art. 2. These forms are Collective Name Partnership, Simple Commandite Partnership, Joint Venture, Joint Stock Company, Share Commandite Company, Limited Liability Company, Variable Capital Company, and Co-Operative Company.

<sup>5</sup>*Id.* arts. 51 and 52.

<sup>6</sup>The second shareholder need only own a nominal single share or unit of participation.

<sup>7</sup>ROYAL DECREE NO. M/6, *supra*, note 3, art. 158. All of the dollar amounts in this article are based on a Saudi riyal 0.3/\$1 exchange rate.

<sup>8</sup>ROYAL DECREE NO. M/4 of 2.2.1399 A.H. (January 1, 1979).

<sup>9</sup>*Id.* art. 2.

<sup>10</sup>MINISTRY OF INDUS. RESOLUTION NO. 952 of 4.11.1400 A.H. (Oct. 3, 1980), art. 1.

tured materials into fully made goods, including the packaging and wrapping thereof.”<sup>11</sup>

Contracting projects consist of projects which “undertake to complete specific work for the account of others.” Contracting is classified into three categories: “(a) Civil engineering construction; (b) Electrical projects contracting such as power generation stations and related works and electronics projects; (c) Mechanical projects such as desalination plants or factories.”<sup>12</sup>

Service projects include such diverse activities as banking, hotel operation and maintenance activities, stevedoring, advertising, cold storage facilities and large warehouses.<sup>13</sup> Agricultural development projects are classified into farming, animal husbandry, and fishing or fish farming projects.<sup>14</sup> Health projects refer to “the establishment, management and operation of hospitals, clinics, sanatoriums and similar institutions.”<sup>15</sup> The FCIC may recommend from time to time that other projects, which do not fall into any of the foregoing categories, be classified as economic development projects.<sup>16</sup>

### *B. Temporary Establishments*

Foreign contractors and subcontractors who obtain a government contract and do not otherwise have a Saudi subsidiary to perform this contract must register a temporary branch in Saudi Arabia.<sup>17</sup> In order to obtain a temporary branch registration, the contractor must file with the Ministry of Commerce, within thirty days of signing the government contract, an application including certain details of the contract, such as the price, the name of the agent,<sup>18</sup> the address of the applicant’s in-kingdom office, and also the address and name of the applicant’s local manager. The applicant must also submit certain documents with his application: a power of attorney authorizing a resident manager to submit the application, a copy of the contract between the non-Saudi and Saudi customer, or a copy of the subcontract if the applicant is a subcontractor, a copy of the agency agreement between the applicant and his Saudi agent, a list of the foreign companies represented by the agent, a copy of the agent’s commercial registration, and a copy of the applicant’s certificate of incorporation in his home country. The branch registration is usually granted within several weeks of filing the application.

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<sup>11</sup>*Id.* art. 2.

<sup>12</sup>*Id.* art. 6.

<sup>13</sup>*Id.* art. 5.

<sup>14</sup>*Id.* art. 3.

<sup>15</sup>*Id.* art. 4.

<sup>16</sup>*Id.* art. 7.

<sup>17</sup>MINISTRY OF COM. RESOLUTION No. 680 of 9.11.1398 (October 10, 1978).

<sup>18</sup>See Audhali, *Role of Saudi Agent under Business Licenses*, INT’L LAW. NEWSLETTER, Vol. III, No. 2, March/April 1981, at 6, which states that a subcontractor must have a Saudi service agent to register under Resolution No. 680.

The temporary branch registration is limited to the scope and time of the contract, that is, the contractor could not use this registration to perform other contracts unrelated to the one which formed the basis for the temporary branch registration. If a contractor has multiple projects in the kingdom, the ministry of commerce may consolidate all these projects under one temporary registration. The contractor must file local financial statements with the Department of *Zakat* and Income Tax in each fiscal year together with a report on its activities within Saudi Arabia after registration. The temporary branch registration allows the contractor to hire locals, rent offices in Saudi Arabia, and obtain visas for its expatriate workers.

Foreign companies quite often "second" their employees to Saudi companies as another means of doing business in Saudi Arabia, although this practice seems to be declining, especially since the promulgation of the temporary branch registration procedure. The non-Saudi company, in this situation, typically has a subcontract with a Saudi company, which requires the subcontractor to have personnel in the Kingdom of Saudi Arabia. The Saudi company will sponsor the subcontractor's personnel as if they were its own employees, to enable them to obtain Saudi residence visas, which would not otherwise be available to the non-Saudi company.

### III. Incentives for Foreign Investors

The Foreign Capital Investment Regulations offer significant incentives to encourage foreign investment in economic development projects in the kingdom.<sup>19</sup> The most important of these incentives is a tax-free holiday for the foreign partner in economic development projects. Industrial and agricultural projects receive ten-year tax holidays while contracting projects receive five-year tax holidays.<sup>20</sup> In order to enjoy these tax holidays, the project must have at least 25 percent Saudi ownership.

The tax holiday commences from the date of production of the project.<sup>21</sup> This date is very important since contracts signed before the commencement of the tax holiday will be subject to taxation. The commencement of production date is not defined in the regulations and can be the date of issuance of the foreign capital investment license, the date of the commercial registration number, or the date when the project actually opened for business. Economic development projects are also allowed to own real estate subject to the Regulations on Ownership of Real Estate by Foreigners.<sup>22</sup> Under these regulations, projects must obtain permission to own real

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<sup>19</sup>ROYAL DECREE NO. M/4 OF 2.2.1399 A.H. (January 1, 1979), superseding ROYAL DECREE NO. 35 (February 25, 1965).

<sup>20</sup>*Id.* art. 7(b).

<sup>21</sup>*Id.* art. 7(c).

<sup>22</sup>*Id.* art. 7(b). The pertinent provisions of Saudi law which apply to the ownership of Saudi real estate are as follows:

A non-Saudi shall not be allowed by any means, other than by succession to acquire the right of ownership or any other right in rem with regard to real estate located within the Kingdom of Saudi Arabia save for such cases as specified in these regulations.

estate from the Real Estate Committee of the Ministry of Industry and Electricity. This permission is rarely granted.<sup>23</sup>

The Saudi Industrial Development Fund (SIDF) was organized by the Saudi Government in 1974 to foster the development of industrial projects through low-cost financing.<sup>24</sup> SIDF loans are only available to wholly Saudi-owned industrial companies or joint ventures with foreign participation. The SIDF can finance up to a maximum of 50 percent of a project's financial requirements.<sup>25</sup> The maximum term of any loan is fifteen years.<sup>26</sup>

Projects with an FCIL also enjoy the incentives provided to Saudi-owned entities under the Regulations for the Protection and Encouragement of National Industries.<sup>27</sup> The most important of these incentives include leases at industrial zones at nominal rents,<sup>28</sup> and exemption from customs duties on raw or semi-processed materials providing these are not locally available in Saudi Arabia.<sup>29</sup> Customs duties exemptions must be obtained by way of an application to the Ministry of Industry and Electricity. Individual businesses plus certain sectors of the industrial infrastructure can enjoy customs exemptions.<sup>30</sup> The Ministry of Industry and Electricity may also protect local manufacturers by prohibiting the importation of competitive products or by raising customs duties on competitive imports.<sup>31</sup>

The Ministry of Industry and Electricity prepares biannual lists of locally manufactured goods, which are distributed to government agencies after checking their prices, quality and availability. These lists are supposed to form the basis for government procurement preferences.<sup>32</sup> In practice, locally sourced goods often are not competitive with imported lower price products, despite these preferences.

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Foreign establishments licensed to operate in the Kingdom of Saudi Arabia according to Foreign Capital Investment Regulations may own real estate required for undertaking their licensed activities, within the limitations of what is necessary, including such premises as may be needed for the dwelling of the employees of the establishment concerned provided a license is obtained from the Minister of Commerce and Industry.

The Decree goes on to state:

It shall be prohibited for notaries public or any other authority to authenticate contracts or notarize any deed incompatible with the provisions of these regulations.

ROYAL DECREE NO. M/22 of 7.12.1390 A.H. (September 13, 1970), art. 3. *See also* MINISTRY OF INTERIOR CIRCULAR NO. WB/K/419S dated 3.9.1395 A.H.

<sup>23</sup>Rous, *Foreign Property Ownership*, SAUDI BUS. July 25, 1980, at 14, 15.

<sup>24</sup>ROYAL DECREE NO. M/3 of 26.2.1394 A.H. (March 20, 1974).

<sup>25</sup>*Id.* art. 6.

<sup>26</sup>*Id.* art. 8.

<sup>27</sup>ROYAL DECREE NO. 50 of 23 Dhal-Hijjah 1381 A.H. (June 1, 1962).

<sup>28</sup>*Id.* art. 6.

<sup>29</sup>*Id.* arts. 4 and 5.

<sup>30</sup>Rous, *Customs and Duties Exemptions*, SAUDI BUS. August 5, 1980 at 31.

<sup>31</sup>ROYAL DECREE NO. 50, *supra*, note 27, art. 8. *See also* Gosaibi *Outlines Industrial Electricity Policies*, SAUDI ECON. SURVEY, January 9, 1980 at 14, 15.

<sup>32</sup>MINISTERIAL DECISION NO. 377 of 18.4.1398 A.H. (March 27, 1978).

#### IV. Saudi Tender Regulations

The basic rules governing procurement by government entities in Saudi Arabia are set forth in the Tender Regulations<sup>33</sup> and the Implementing Regulations to the Tender Regulations.<sup>34</sup> These regulations apply to most Saudi government ministries, agencies and companies wholly owned by the Saudi government; but they do not apply to companies in which the Saudi government is only a shareholder, and to agencies which have their own procurement rules such as the Royal Commission for Jubail and Yanbu.<sup>35</sup>

The Tender Regulations require a minimum amount of bidders on any given project in order to assure competitive bidding. For example, on construction works, at least five contractors must be invited to bid, and on operation and maintenance works there must be at least three invitees to bid.<sup>36</sup>

The Tender Regulations impose various unconditional first demand guarantee requirements on contractors. Contractors must submit with their bid a 1 percent or 2 percent bank guarantee.<sup>37</sup> These bid guarantees must last from the time of bid until contract award as specified in the tender documents. The bid bond will be forfeited if the contractor withdraws his bid during this period or refuses to enter into the contract if awarded to him.<sup>38</sup> If a contract is not awarded during the prescribed period as specified in the tender specifications, the government customer can ask the bidder to extend the bid guarantee. If the bidder does not notify the customer of its intention not to renew the bid guarantee, it will be considered to have been automatically renewed. There have been cases where the government customer required all bidders to extend their bid guarantees.<sup>39</sup>

A contractor to the Saudi government must take out an unconditional performance guarantee of 5 percent of the contract value within ten days of contract award,<sup>40</sup> except in the case of contracts for consultancy work and purchase of spare parts.<sup>41</sup> The bid guarantee will be returned to the contractor, once he produces the performance guarantee. If the guarantee is from an insurance company, it must be at least 25 percent of the contract value.<sup>42</sup> The performance guarantee remains valid until final acceptance of the contract by the government customer.

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<sup>33</sup>ROYAL DECREE NO. M/14 OF 7.4.1397 (March 27, 1977).

<sup>34</sup>MINISTERIAL RESOLUTION NO. 2131/97 OF 5.5.1397 A.H. (April 23, 1977).

<sup>35</sup>Address by Salah Hejailan, Esq., Conference on International Contractual Guarantees, Madrid (March 11-12, 1981). See also *Aramco's Procurement Regulations to Remain*, MIDDLE E. EXECUTIVE REP., October 1980, at 31, which states that Aramco operates under its own procurement procedures.

<sup>36</sup>ROYAL DECREE NO. M/14, *supra*, note 33, art. 3(a), (d).

<sup>37</sup>*Id.* art. 2(d).

<sup>38</sup>Address by Salah Hejailan, Esq., *supra*, note 35.

<sup>39</sup>*Id.*

<sup>40</sup>MINISTERIAL RESOLUTION NO. 2131/97, *supra*, note 34, art. 21.

<sup>41</sup>*Id.* art. 7(a).

<sup>42</sup>*Id.* art. 7(d).

If the government customer gives the contractor an advance payment of 20 percent of the contract value, which is quite customary, the contractor must post an unconditional bank guarantee for the same amount.<sup>43</sup> This guarantee will normally be reduced in direct relation to the proportionate size of installment payments given to the contractor by the customer. Since the reduction of the advance payment guarantee is not automatic, the contractor should attempt to define in its contract the method under which this guarantee will be reduced.<sup>44</sup> The government customer will also require a retention guarantee of usually 5 percent of the contract value.<sup>45</sup> This guarantee is held until the contractor produces proof in the form of a certificate from the Department of *Zakat* and Income Tax that it has no outstanding Saudi tax liabilities.<sup>46</sup>

While the unconditional nature of these various guarantees seems to present a high degree of risk of arbitrary or unreasonable drawdown, the Saudi government is extremely reluctant to call these guarantees without clear justification.<sup>47</sup> In practice, this has meant that guarantees have been called only in egregious cases such as inability of the contractor to complete the project, or bankruptcy of the contractor.

Guarantees are always drawn upon in their full amount even if the guarantee's face value exceeds the government's claim. The government customer will use the proceeds to recoup not only its own claims but those of other government ministries. The contractor's creditors are usually invited by public announcement to satisfy any claims they may have against the contractor out of the guarantee proceeds.<sup>48</sup>

The various delay penalties on contractors are found in both the Tender Regulations and the Implementing Regulations to the Tender Regulations. For supply contracts, the fine is 1 percent of the value of the delayed work for each week of delay up to a maximum of 4 percent of the total contract value;<sup>49</sup> and for consultancy contracts, the fine is 1 percent of the delayed value of the work for each month of delay up to a maximum of 10 percent of the total contract value.<sup>50</sup> On maintenance and operation contracts, the fine shall be specified in the contract but shall not exceed 10 percent of the total contract value.<sup>51</sup> Fines on delays for public works contracts go up to a maximum of 10 percent of the total contract value.<sup>52</sup>

A contractor cannot assign the contract in whole or in part without the prior written consent of the Saudi government customer. If the contract is

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<sup>43</sup>*Id.* art. 8(a).

<sup>44</sup>Address by Salah Hejailan, Esq., *supra*, note 35.

<sup>45</sup>*Id.*

<sup>46</sup>ROYAL DECREE NO. M/14, *supra*, note 33, art. 8(b).

<sup>47</sup>Address by Salah Hejailan, Esq., *supra*, note 35.

<sup>48</sup>*Id.*

<sup>49</sup>MINISTERIAL RESOLUTION NO. 2131/97, *supra*, note 34, art. 34.

<sup>50</sup>*Id.* art. 35.

<sup>51</sup>*Id.* art. 36.

<sup>52</sup>*Id.* art. 37.

so assigned, the original contractor remains jointly liable with the assignee for contract performance.<sup>53</sup> The Saudi government customer can raise or lower the scope of the contract by as much as 20 percent of its value.<sup>54</sup> The Saudi government customer has the right to hold the contractor's tools, equipment and materials and use them to complete the works in the event the contractor has failed to adequately perform the contract.<sup>55</sup> The Tender Regulations call for the issuance of standard contract forms by the Saudi Council of Ministers for public works supply and other public procurement types of contracts.<sup>56</sup> To date, these forms have not been issued.

An important rule outside the Tender Regulations, but which affects government contracts, is found in a 1963 Decision of the Council of Ministers which prohibits government agencies from adopting non-Saudi arbitration or foreign governing law.<sup>57</sup> A choice of foreign law in a government contract would, therefore, be unenforceable in Saudi Arabia. Governing law is to be determined by the usual rules governing conflict of law situations.<sup>58</sup>

## V. Dicennial Liability and Warranty

The Implementing Regulations to the Tender Regulations set forth the basic rule on dicennial liability in Saudi Arabia:

The contractor shall guarantee any total or partial collapse of his works within ten years from the date of delivery thereof to the government agency by him, if this has resulted from a defect in implementation, unless both contracting parties have agreed that the works should remain sound for a period of less than ten years.<sup>59</sup>

Dicennial liability in Saudi Arabia is a form of strict liability in that the Saudi government customer need not prove negligence or fault on the part of the contracting firm in collecting damages against that firm. Dicennial liability cannot be waived because it is imposed by law, unless the parties agree or it can be demonstrated that the civil works in issue had a useful life of less than ten years. The contractor, in the event of a claim, could defend itself on the grounds of misuse of the structure by the customer.

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<sup>53</sup>*Id.* art. 28.

<sup>54</sup>*Id.* art. 25.

<sup>55</sup>*Id.* art. 33. In Saudi Arabia, a security interest in movables only arises through possession.

<sup>56</sup>ROYAL DECREE NO. M/14, *supra*, note 33, art. 10.

<sup>57</sup>MINISTERIAL RESOLUTION NO. 58 OF 17.1.1383 A.H. A notable exception to this resolution was the recent Saudi ratification of the International Center for the Settlement of Investment Disputes Convention (the ICSID Convention). The ICSID Convention provides a forum for the arbitration of disputes between governments and private parties arising out of investments made by such private parties in the host country. Ratifiers of this convention waive local jurisdiction and agree to be bound by the decision of the ICSID. Private parties in Saudi Arabia may specify a non-Saudi forum for adjudication of disputes. There are, however, few practical benefits to this since Saudi courts give little weight to non-Saudi arbitral or judicial decisions. A non-Saudi plaintiff would most likely have to relitigate the case in Saudi Arabia unless the Saudi defendant had assets outside of Saudi Arabia against which he could proceed.

<sup>58</sup>Ford and Bixler, *Middle East Construction Contracting*, GOV'T CONTRACTOR BRIEFING PAPERS, No. 77-3, June 1977, at 11.

<sup>59</sup>MINISTERIAL RESOLUTION NO. 2131/97, *supra*, note 34, art. 30.

There is no statutory warranty for manufactured goods under Saudi law. The parties to a contract, whether the customer is public or private, are free to agree on any contractual warranties provided they do not violate the *Sharia's* principles of equity and fairness. A warranty may also arise by implication through the acts and representations of the contractor.

Unlike the United States and many other jurisdictions, there is no statute of limitations in Saudi Arabia.<sup>60</sup> A Saudi customer could sue a manufacturer for a defective product without regard to the amount of elapsed time from the sale. It may be possible to defend such a suit under the *Sharia* on the grounds that it is unjust to hold a party liable for its product or services for an indefinite period into the future.

## VI. Agency Regulations

Saudi regulations classify agents into two categories: service agents, i.e., commission agents, and merchants engaged in the resale of goods in Saudi Arabia. The basic rules governing the use of service agents are contained in the Service Agency Regulations<sup>61</sup> which apply to all contracts between foreign contractors and the Saudi government.<sup>62</sup> These regulations contain the following basic requirements:

- a. A foreign contractor, unless it has a Saudi partner, must have a Saudi agent.<sup>63</sup>
- b. Agents cannot be used on armaments contracts or on government-to-government contracts.<sup>64</sup>
- c. The agent must be a Saudi citizen resident in Saudi Arabia and be duly registered in the Saudi commercial registry as an agent.<sup>65</sup>
- d. An agent may represent a maximum of ten principals. Contractors may have multiple agents but cannot use more than one agent on any single project.<sup>66</sup>
- e. The maximum commission payable to an agent is 5 percent of the contract value.<sup>67</sup>
- f. An agent cannot be the consultant and an agent on any single project.<sup>68</sup>

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<sup>60</sup>Nazer, *Sharia Law and Its Commercial Application*, MIDDLE E. EXECUTIVE REP., September 1979, at 2, 17.

<sup>61</sup>ROYAL DECREE NO. M/2 of 21.1.1398 A.H. (January 20, 1978).

<sup>62</sup>*Id.* art. 2.

<sup>63</sup>*Id.* art. 3.

<sup>64</sup>*Id.* art. 4. It is generally believed that "armaments" in this context only refer to destructive instruments and not to such defense items as military hospitals, radar, or trucks.

<sup>65</sup>*Id.* art. 5.

<sup>66</sup>*Id.* art. 6.

<sup>67</sup>*Id.* art. 8.

<sup>68</sup>*Id.* art. 9.

g. An agent cannot be used to exercise undue influence for purposes of obtaining a contract.<sup>69</sup>

The Commercial Agency Regulations require that any import resale activities which take place within Saudi Arabia must be performed by a company of 100 percent Saudi ownership.<sup>70</sup>

Natural or juristic persons, other than Saudi nationals, may not be commercial agents in the Kingdom of Saudi Arabia; however, the capital of Saudi companies, who carry on commercial agency activities, shall be owned in full by Saudi nationals and the directors thereof and persons vested to sign therefor shall also be Saudis.<sup>71</sup>

The penalties for contravention of these regulations range from a fine of between \$300 and \$1,500.<sup>72</sup> If the transgressor is a foreigner or a Saudi company with one or more foreign partners, the punishment could range from prohibition from doing business in Saudi Arabia for a certain period of time or the permanent expulsion of the foreigner from Saudi Arabia.<sup>73</sup>

It is widely believed that foreign firms or Saudi companies with foreign participation can import and resell products in Saudi Arabia as long as these products are sold as part of an installation, erection or repair contract. The Commercial Agency Regulations do not prohibit the sale of manufactured goods by duly licensed Saudi companies with foreign ownership, who have manufactured these goods in Saudi Arabia.<sup>74</sup>

The recently issued Implementation Regulations to the Commercial Agency Regulations require agents of non-Saudi companies to maintain a supply of spare parts in Saudi Arabia for the products covered by their agency agreements.<sup>75</sup> Agents must also provide maintenance capabilities for these products and guarantee the products until the earlier of one year after the expiration of their agency agreement or the appointment of a successor agent.<sup>76</sup> These Implementing Regulations also contain a recommended form of agency agreement.

Unlike some other countries, there are no statutory penalties or compensation for termination of agency or distributorship agreements by the foreign principal in Saudi Arabia. However, the foreign principal, if it terminates such agreements, may have to pay the agent or distributor for their unrecovered costs such as showroom costs or termination pay of

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<sup>69</sup>*Id.* art. 10. See also the Regulation on Combatting Bribery, ROYAL DECREE NO. M/38 of 1378 A.H. (1958). The Saudis recently banned Hyundai Construction Company from doing business in Saudi Arabia for two years and fined Hyundai \$90.9 million for trying to bribe government officials. Wall St. J. May 5, 1980 at 16, col. 3.

<sup>70</sup>ROYAL DECREE NO. 11 of 20.2.1382 A.H., as amended by ROYAL DECREE NO. M/8 of 1973.

<sup>71</sup>*Id.* art. 1.

<sup>72</sup>*Id.* art. 4.

<sup>73</sup>*Id.*

<sup>74</sup>Rous, *Complex Legal Process Rules Local Industry*, SAUDI BUS., December 5, 1980 at 48, 50.

<sup>75</sup>MINISTRY OF COM. RESOLUTION NO. 1897 of 24.5.1401 A.H. (March 30, 1981), art. 3(1).

<sup>76</sup>*Id.* art. 3(2).

employees. The principal could also be required to buy back unsold inventory held by the agent or distributor.<sup>77</sup> In view of the close-knit Saudi business community, the political costs of terminating an agent or distributor could well outweigh the immediate financial costs of such action.

## VII. Labor and Visa Regulations

The Labor and Workers' Regulations (the Labor Regulations) govern the relationship between employer and employee. They also provide a forum for the resolution of disputes between these parties and establish basic ground rules for the entry of foreign workers in the kingdom.<sup>78</sup>

### A. Residence and Work Permit Requirements

A foreigner cannot be employed in the kingdom unless he has obtained a work permit from the Saudi Labor Ministry, has complied with residence regulations, possesses the skills needed in the kingdom (provided there are not enough Saudis to fill these positions), and has a contract with a Saudi or a non-Saudi company licensed to operate in the kingdom.<sup>79</sup>

It shall not be allowed to import foreigners to work or permit them to do work with private companies or firms except pursuant to the Minister of Labor's approval and after the receipt of a work permit as per the pro-forma, proceedings and rules laid down by the Labor Ministry. . . .<sup>80</sup>

The Saudis have recently tried to curtail the large influx of foreigners to Saudi Arabia by restricting the issuance of residence visas (*igamas*)<sup>81</sup> to dependents of two categories of foreigners.<sup>82</sup> Those in the first category, which includes university professors, teachers, doctors, pharmacists, veterinarians, engineers, arms and ammunition experts, managers of companies with at least one hundred employees or at least \$300,000 in sales/year or in capital, can obtain residence visas for dependents without any conditions. Those in the second category, namely accountants, legal consultants, laboratory assistants, nurses and engineering draftsmen, who are graduates of specialized scientific and technical institutions, must reside for at least one year in Saudi Arabia, work in their field of expertise, and have a salary of at least \$12,000/year, unless they are government employees, before bringing their dependents into Saudi Arabia.<sup>83</sup>

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<sup>77</sup>Cartwright, *Saudi Arabian Service and Commercial Agents*, MIDDLE E. EXECUTIVE REP., October 1979, at 3, 17.

<sup>78</sup>ROYAL DECREE NO. M/21 of 6.9.1389 A.H. (January 15, 1969).

<sup>79</sup>*Id.* art. 49.

<sup>80</sup>*Id.*

<sup>81</sup>The procedure for obtaining residence visas is quite complicated, changes frequently, and can be a source of particular frustration for foreign firms working in the kingdom. The Government Recruiting Bureau of the Ministry of Interior is responsible for issuing work visas and family residence visas.

<sup>82</sup>Ministry of Interior Statement of August 29, 1980.

<sup>83</sup>SAUDI ECON. SURVEY, September 3, 1980 at 6.

*B. Employer/Employee Relationship*

An employee's rights under the Labor Regulations cannot be waived by the employee even if this waiver is effectuated by a written agreement.<sup>84</sup> The Labor Regulations apply to all workers in the kingdom with the exception of family members working in a family enterprise, farm workers, and domestic workers.<sup>85</sup>

The Labor Regulations are designed to promote the employment and training of Saudis. For example, any employer of one hundred or more employees must train a number of Saudis equal to at least 51 percent of his work force.<sup>86</sup> Saudis must constitute at least 75 percent of the total work force of any particular employer, and Saudis' wages should be at least 51 percent of total employees' wages.<sup>87</sup> These provisions are generally not enforced because of the significant shortages in the Saudi labor force.

Employment contracts may be for definite or indefinite terms.<sup>88</sup> If the contract is for an indefinite term, either party may terminate it upon thirty days' written notice.<sup>89</sup> Employment contracts must be written in Arabic and must be given to each party. An employment contract shall be deemed to exist even if it is unwritten. If the contract is unwritten, either the employer or the employee may require that the contract be reduced to writing at any time.<sup>90</sup>

Employees alleging wrongful dismissal may petition the local Director of the Labor Office for a stay of the dismissal and for a mediation of the dispute. If the Labor Director cannot settle the dispute, he will pass the petition to the Regional Committee for the Settlement of Labor Disputes.<sup>91</sup>

Employers shall not pay non-Saudi workers higher wages than Saudi workers of the same qualifications unless this is necessary to attract the foreign worker. An employer must pay a bonus to the employee if the employer terminates the employment contract for reasons other than as set forth in the Labor Regulations.<sup>92</sup>

An employee may treat the employment contract as if it were rescinded if the employer breaches the employment contract, provides dangerous working conditions, or commits physical violence against the employee.<sup>93</sup> Wages shall be paid weekly, except for monthly rate workers who shall be paid monthly.<sup>94</sup>

In general, the workday shall not exceed eight hours and the work week

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<sup>84</sup>ROYAL DECREE NO. M/21, *supra*, note 78, art. 6.

<sup>85</sup>*Id.* art. 3.

<sup>86</sup>*Id.* art. 44.

<sup>87</sup>*Id.* art. 45.

<sup>88</sup>*Id.* art. 70.

<sup>89</sup>*Id.* art. 73.

<sup>90</sup>*Id.* art. 77.

<sup>91</sup>*Id.* art. 75.

<sup>92</sup>*Id.* art. 83.

<sup>93</sup>*Id.* art. 84.

<sup>94</sup>*Id.* art. 116.

shall not exceed forty-eight hours.<sup>95</sup> Friday is the official day off with full pay.<sup>96</sup> After one year, employees are entitled to fifteen days paid vacation and after three years, twenty-one days paid vacation.<sup>97</sup>

The Labor Regulations provide a two-tier system for the adjudication of labor disputes consisting of the Preliminary Committee for the Settlement of Labor Disputes and the Supreme Committee for the Settlement of Labor Disputes.<sup>98</sup> Appeals can be made from the Preliminary Committee for the Settlement of Labor Disputes to the Supreme Committee for the Settlement of Labor Disputes, which is the forum of final adjudication.

Labor unions are forbidden in Saudi Arabia.<sup>99</sup> Persons who incite others to strike are subject to imprisonment for up to three years and/or a fine of up to approximately \$3,000.<sup>100</sup>

### C. Social Security

Both Saudis and non-Saudis who mainly work in Saudi Arabia are subject to the Saudi social security system. Social security benefits include medical coverage for occupational risks for which the employer must contribute 2 percent of the employee's wages.<sup>101</sup> This coverage includes medical care, incapacity and lump sum payments related to labor accidents "suffered by the insured, regardless of cause, as well as any accident which is suffered by the insured while on his way from his residence to his place of work or vice versa . . .," on the way to his meal, or while on a trip at the request of his employer.<sup>102</sup> Labor accidents include certain specified occupational diseases.<sup>103</sup> Employees who have paid into the social security system for the prescribed periods are entitled to an old-age pension at age sixty.<sup>104</sup> Employers must contribute 8 percent of the employee's wages while the employee must contribute 5 percent for this coverage.<sup>105</sup>

## VIII. Taxation

The Department of *Zakat* and Income Tax<sup>106</sup> of the Ministry of Finance is responsible for tax administration in Saudi Arabia. Saudi individuals and companies of 100 percent Saudi ownership are not subject to income

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<sup>95</sup>*Id.* art. 147.

<sup>96</sup>*Id.* art. 149.

<sup>97</sup>*Id.* art. 153.

<sup>98</sup>*Id.* art. 172. These committees are an integral part of the Saudi legal system, and, as such, are subject to Islamic jurisprudence in addition to the labor regulations. Taylor, *Changing Circumstances: Saudi Labor Law and Recent Developments*, 12 INT'L LAW. 661, 663 (1979).

<sup>99</sup>ROYAL DECREE NO. 2639 of 1378 A.H. (1958).

<sup>100</sup>ROYAL DECREE NO. M/21, *supra*, note 78, art. 190.

<sup>101</sup>ROYAL DECREE NO. M/22 of 6.9.1389 A.H., art. 18.

<sup>102</sup>*Id.* art. 27(1).

<sup>103</sup>*Id.* art. 27(2).

<sup>104</sup>*Id.* art. 38.

<sup>105</sup>*Id.* art. 18(2).

<sup>106</sup>Established by MINISTERIAL RESOLUTION NO. 1399 of 7.8 1370 A.H. (June 14, 1956).

tax.<sup>107</sup> However, Saudis and Saudi companies are subject to *zakat*, which is a 2½ percent annual tax on net worth.<sup>108</sup> The individual income tax was abolished in 1975.<sup>109</sup>

Foreign companies are subject to Saudi income tax on their net profit, which is gross income less allowable deductions.<sup>110</sup> Gross income includes:

. . . all the income, profits, earnings of whatever kind and in whatever form paid resulting from all kinds of industry and commerce such as buying and selling, financial or commercial transactions . . . receive[d] locally from any source whatsoever in the Kingdom.<sup>111</sup>

The tax rates on company profits are: (a) 25 percent of annual profits up to \$30,000; (b) 35 percent of annual profits between \$30,000 and \$150,000; (c) 40 percent of annual profits between \$150,000 and \$300,000; and (d) 45 percent of annual profits in excess of \$300,000.<sup>112</sup> Deductible expenses include all ordinary and necessary business expenses, such as travel expenses related to the business, rentals of business properties, uncompensated losses of the business, and reasonable amounts for depreciation of business properties.

The Saudi and non-Saudi partners in a Saudi joint venture are subject to different tax treatment. Since Saudis are only subject to the *zakat* tax, a Saudi partner pays 2½ percent on the amount by which his proportionate net profit from the joint venture increases his net worth, while the non-Saudi partner is taxed on his share of the net profit at the applicable corporate tax rate. Non-Saudi companies with more than one joint venture in Saudi Arabia are not allowed to file a consolidated return and offset one taxable entity's gains with the losses of a separate taxable entity.<sup>113</sup>

Saudi Arabia taxes Saudi source income whether or not the taxpayer is a Saudi-based company.<sup>114</sup> For example, an American company exporting goods from the United States with no contractual responsibilities inside Saudi Arabia will not be subject to Saudi tax. If the exporter is responsible for in-kingdom transportation of the goods, or for installation services in

<sup>107</sup>ROYAL DECREE No. 3321 of 21.1.1370 A.H., as amended by ROYAL DECREE No. 576 of 14/1/1376 A.H., art. 1.

<sup>108</sup>Bahrainis, Kuwaitis, and Qataris also only have to pay the *zakat* tax in accordance with ROYAL DECREE NOS. 10236 and 10237 of 14.1.1376 A.H. (November 17, 1956); ROYAL DECREE No. 800 of 9.11.1376 A.H. (August 16, 1956); and ROYAL DECREE No. 4899 of 27.5.1377 A.H. (December 19, 1957). See also MINISTERIAL RESOLUTION No. 340 of 1.7.1370 A.H. (May 8, 1951).

<sup>109</sup>ROYAL DECREE No. M/637 of 4.15.1395 A.H. (May 15, 1975). See Implementing Regulations in Circular No. 3 of the Department of *Zakat* and Income Tax of 15.5.1395 A.H. (1975).

<sup>110</sup>ROYAL DECREE No. 3321, of 21.1.1370 A.H., art. 12.

<sup>111</sup>*Id.* art. 13.

<sup>112</sup>*Id.* art. 14. There is no loss carryforward in Saudi Arabia. Instructions on Income Tax Circular Letter No. 2 of 1392 (1972).

<sup>113</sup>*Id.* art. 11.

<sup>114</sup>Department of *Zakat* and Income Tax Circular No. 10989/2 of 26.11.1400 A.H.

Saudi Arabia, it may be subject to Saudi Arabian taxes on the sale.<sup>115</sup>

Taxpayers in Saudi Arabia must file annually a profit and loss account with the Department of *Zakat* and Income Tax, certified by a public accountant. The return must normally contain depreciation and salary schedules, subcontractor payments, and interest, insurance and lease payments.<sup>116</sup> There are no prescribed income tax forms in Saudi Arabia.

Saudi government customers generally require the contractor to produce a current Department of *Zakat* and Income Tax certificate showing payment of taxes. Even if the contractor enjoys a tax holiday, it must file annual tax returns and produce this certificate to show that it has duly filed the tax return.<sup>117</sup>

## IX. Intellectual Property Rights

Saudi Arabia has no statutory protection for patents. A system of cautionary notices does provide, however, some protection for patent rights. Under this method, cautionary notices are published in the *Um Al Qura*, the Saudi Official Gazette, indicating that a party is the sole proprietor of an invention and that a patent registration for the invention has been obtained elsewhere in the world. The notice gives particulars of the patent and warns third parties against potential infringement.<sup>118</sup>

An aggrieved party can sue the alleged infringer in the Committee for the Settlement of Commercial Disputes<sup>119</sup> which can enjoin the infringement

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<sup>115</sup>See Circular Letter No. 2, Department of *Zakat* and Income Tax of 1389 A.H., "Income is subject to tax [in Saudi Arabia] if it is obtained from a local source in the Kingdom as a result of work within the Kingdom or combined work within and outside the Kingdom." The Circular Letter gives some examples of the type of activities conducted by a foreign company in Saudi Arabia which would subject the transaction to taxation there. A contract signed within the kingdom by the representative of a company or establishment which undertakes to import materials and deliver them in Riyadh, for example, or in any other place in the kingdom, is considered a commercial practice within the kingdom and subject to income tax. The mere process of providing transport from the port of arrival to the place of delivery is considered to be practicing work within the kingdom. See also Ball & Walsh, *Tax Consequences of U.S. Investments in Select Middle Eastern Countries*, 37 NYU INST. FED. TAX., 8-1, at 8-11 (1979).

<sup>116</sup>Gorab, *Current Tax Practice*, MIDDLE E. EXECUTIVE REP., October 1980, at 3, 22.

<sup>117</sup>MINISTERIAL RESOLUTION NO. 340 of 1.7.1370 A.H. (May 8, 1951). See MINISTERIAL RESOLUTION NO. 8853 of 20.4.1391 A.H. which authorizes government customers to withhold final payment or the release of guarantees until a current Department of *Zakat* and Income Tax certificate is produced by the contractor.

<sup>118</sup>Rous, *Patent, Copyright and Trademark Protection*, SAUDI BUS., August 1, 1979 at 17.

<sup>119</sup>The Saudi judicial system is organized into three branches. The Ministry of Justice administers the *Sharia* court system which has cognizance over criminal, family, and minor civil matters. The Grievance Board handles disputes between government agencies and private parties. Various Saudi ministries, such as the Ministry of Labor and the Ministry of Interior adjudicate disputes falling within their area of responsibility. The Committee for the Settlement of Commercial Disputes handles commercial disputes between private parties. Procedures under any of these various bodies are informal in comparison to the American judiciary. *Judicial Authority and the Court System of Saudi Arabia*, MIDDLE E. EXECUTIVE REP., September 1979, at 2, 14-17.

or award damages.<sup>120</sup> There are no Saudi copyright laws although a claimant may have some protection under general property rights found in the *Sharia*,<sup>121</sup> and there are no Saudi government approvals or registration requirements on the transfer of technology to Saudi Arabia.

Saudi trademark law is embodied in the Regulations for the Registration of Trademarks.<sup>122</sup> A trademark is defined as "a mark placed upon any commodity to denote that it belongs to the owner of such mark because it has been manufactured, invented, selected, dealt in or offered for sale by such owner."<sup>123</sup> The Trademark Regulations established a central register of trademarks.<sup>124</sup> Applications to register trademarks are made at the Trademarks Registry Office, and must include a representation of the mark, a list of goods on which the mark will be used, and the origin of these goods.<sup>125</sup> These applications are published in the *Um Al Qura*, following which objections may be lodged to the registration of the trademark.<sup>126</sup>

Parties can contest the registration of a mark if it has not been used for five consecutive years by the registrant.<sup>127</sup> Trademarks are registered for ten-year periods and are renewable for the same period.<sup>128</sup>

## X. Conclusion

The explosive growth of the Saudi economy has put great demands on its legal system. The last few years in Saudi Arabia have witnessed a quickening in the promulgation of legislation in response to the new complexities of the business environment. It is expected that as this trend continues, access to and understanding of the latest Saudi legal developments will be increasingly critical to successful business there.

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<sup>120</sup>Rous, *Patent, Copyright, and Trademark Protection*, *supra*, note 118.

<sup>121</sup>*Id.*

<sup>122</sup>HIGH DECREE NO. 8762 of 28.7.1358 A.H., as amended by COUNCIL OF MINISTERS RESOLUTION NO. 66 of June 4, 1974 and ROYAL DECREE NO. M/24 of 23.6.1394 A.H.

<sup>123</sup>*Id.* art. 2.

<sup>124</sup>*Id.* art. 4.

<sup>125</sup>*Id.* art. 8.

<sup>126</sup>*Id.* arts. 14 and 15.

<sup>127</sup>*Id.* art. 19.

<sup>128</sup>*Id.* art. 23.