



Entering the Saudi Arabian Market: An Overview of Key Legal Issues

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BAKER BOTTS  **LLP**

- **2 Principal Types of Market Entry--**
 - Sales from Abroad
 - **Goods**
 - **Services**
 - Foreign Direct Investment (FDI)
 - **Branch**
 - **Temporary Commercial Registration (TCR)**
 - For services provided under government contract
 - **100% Foreign Owned Company**
 - **Joint Venture Company**

- **Sales from Abroad**
 - **Sale of Goods**
 - Generally involve Commercial Agent or Distributor
 - Sale of goods not subject to Saudi Arabian Income Tax if structured as "offshore" sale with title passing offshore
 - But In-Kingdom presence by foreign principal or its personnel can lead to Permanent Establishment exposure
 - **Sale of Services**
 - Directly to government customers
 - Directly to companies and parastatal entities (e.g, SEC)
 - Through a Commercial Agent or Distributor
 - All sales will likely result in Saudi Arabian Withholding Tax liability of 5% to 20%

Entering the Saudi Arabian Market

- **Sales from Abroad**
 - **Generally require Commercial Agent or Distributor**
 - **Commercial Agency Regulations**
 - **Require all commercial agency agreements to be registered with Ministry of Commerce & Industry (MoCI)**
 - **Registration can lead to statutory protection for Agent**
 - **Current MoCI policy is not to register "exclusive" agencies**
 - **Commercial Agency agreements easier to terminate than in many other Middle Eastern countries, e.g., U.A.E.**
- **Foreign Direct Investment (FDI)**
 - **Generally routed through Saudi Arabian General Investment Authority (SAGIA)**
 - **Set up in 2000 as One-Stop Shop for Foreign Investors**

Saudi Arabia - Foreign Investment Overview

- **Saudi Arabia is the most liberal jurisdiction for Foreign Direct Investment ("FDI") in the GCC**
 - **100% foreign ownership in Saudi Arabian businesses permitted in most sectors of economy**
 - **"Negative List" issued by Supreme Economic Council prohibits or restricts FDI in certain sectors**
 - **Negative List is updated every 1-2 years to remove sectors**
 - **Saudi Arabia acceded to World Trade Organization in December 2005**
 - **1982 GCC Economic Cooperation Agreement provides for "national treatment" of GCC citizens in most sectors**

Negative List (1)

- **The following sectors are wholly "off limits" to FDI**
 - **Oil & Gas Exploration & Production**
 - **Non-Associated Gas E&P (in JVs w/ Saudi Aramco) is permitted**
 - **Real Estate Brokerage**
 - **Employment / Recruitment Services**
 - **Pilgrim Services in Mecca & Medina**
 - **Military Catering Services**
 - **Primary & Secondary Education**
 - **Publication**
 - **TV and Radio Broadcasting**
 - **Security Services**
 - **Explosives Manufacturing**
 - **Road Transport**

Negative List (2)

- **The following sectors have FDI restrictions**
 - **Domestic Rail Transport**
 - **Telecommunications**
 - **Banking (max. 40% foreign ownership - in Joint Stock Co.)**
 - **Insurance (max. 60% foreign ownership - in Joint Stock Co.)**
 - **Distribution Services (including wholesale & retail trade)**
 - **Maximum 75% Foreign Ownership - if FDI is \geq SR 20 MM**
- **Professions (e.g., law, medicine, accounting) are "civil companies" & are subject to different rules**
 - **Max. 75% foreign ownership in professional companies**

Saudi LLC

- **Most common vehicle for a joint venture in Saudi Arabia is the Saudi Limited Liability Company**
 - **Saudi LLC is really a "limited liability partnership"**
 - **2-50 partners**
 - **Single class of shares**
 - **No share certificates issued**
 - **Limits ability to pledge shares to lenders to Saudi LLC**
 - **May be managed by Partners or Board of Managers**
 - **In a 2-partner LLC, the smaller stake must generally be at least 5%**
 - **Minimum capital requirement was abolished by Ministry of Commerce & Industry ("MoCI") in 2009**

Saudi LLC - Article 180 of Companies Regs.

- If losses of a Saudi LLC exceed 50% of its stated share capital, Article 180 requires the Partners in the Saudi LLC to meet within 30 days of the date losses are recognized, and by 3/4 majority vote:
 - **elect to contribute additional capital to the Saudi LLC;**
or
 - **elect to liquidate and dissolve the Saudi LLC**
- If Partners fail to take such action within 30 days and continue to operate the Saudi LLC, the Partners become "jointly and severally" liable for the debts of the Saudi LLC and any creditor may petition for its liquidation
- Partners in most Saudi LLCs inject add'l capital before close of fiscal year to keep losses above 50% threshold

Saudi LLC

- **Formation of Saudi LLC - Key Documents**
 - **Foreign Investment License** (required for non-GCC foreign investors) - issued by Saudi Arabian General Investment Authority ("SAGIA")
 - **Articles of Association**
 - Best to follow MoCI "standard" form
 - Approved & stamped by MoCI official
 - Executed before Notary Public in KSA
 - **Shareholders / Partners Agreement**
(Recommended)
 - Private agreement among Partners
 - Should "amplify" but not contradict Articles of Association
 - May be governed by foreign law and call for foreign dispute resolution (e.g., LCIA or ICC arbitration).

Saudi LLC

- **Formation of Saudi LLC - Supporting Documents**
 - **Articles of Association of each Partner**
 - Certified copies from country of origin
 - **Board Resolutions**
 - Authorizing investment in Saudi LLC
 - Appointing initial Managers or General Manager ("GM")
 - Authorizing Powers of Attorney for GM
 - Authorizing Special PoA for local attorneys
 - **Powers of Attorney**
 - General PoA for GM
 - Special PoA for local attorneys

Saudi LLC

- **Formation of Saudi LLC - Supporting Documents**
 - **Financial Statements (3+ Years) for Each Partner**
 - Balance Sheet & Profit & Loss Statements
 - May include consolidated financial statements of parent
 - **Secretary's Certificate**
 - Listing Directors of each corporate Partner
 - **Certificate of Incorporation**
 - Certified copy from formation jurisdiction

All Supporting Documents to be Fully Legalized

Legalization Procedures

Saudi Arabia is not a party to Hague Convention Abolishing the Requirement for Legalization of Foreign Public Documents

All foreign public documents to be used in Saudi Arabia must go through full "legalization" process:

- Execution before Notary Public
- Authentication by Circuit Court (rare) - e.g., Virginia, USA
- Authentication by Secretary of State of State or Commonwealth
- Authentication by US Department of State / UK Foreign Office
- Authentication by Royal Saudi Embassy or Consulate
- Authentication by KSA Ministry of Foreign Affairs (Riyadh, etc.)
- **Certified Arabic translation to be appended**
- Authentication by KSA Ministry of Justice (for PoAs & SPoAs)

Saudi LLC - Formation Steps (1)

- **SAGIA Application for Foreign Investment License**
 - SAGIA Application Form
 - Draft Articles of Association of Saudi LLC
 - All Supporting Documentation
 - Confirmation that activities are not on "Negative List"
 - SR 12,000 Application / Subscription Fee
 - **SAGIA frequently changes requirements w/o notice**
- **Bank Account - For Saudi LLC "under formation"**
 - Account in local bank in Saudi Arabia
 - Account Opening Forms to be Completed
 - SAGIA Foreign Investment License to be submitted
 - Resolutions in Form Provided by Saudi Bank
 - Account "frozen" until CR is issued

Saudi LLC - Formation Steps (2)

- **MoCI Application for Saudi LLC Formation**
 - Draft Articles of Association for Saudi LLC
 - All Supporting Documentation
 - SAGIA Foreign Investment License
 - Saudi LLC Articles of Association to be approved and stamped by MoCI in multiple originals
- **Execution of Saudi LLC Articles before Notary Public in Saudi Arabia**
 - Executed under PoA or SPoA
 - Serve to "create" Saudi LLC as among the Partners under *Shari'a* principles recognized in Saudi Arabia

Saudi LLC - Formation Steps (3)

- **Post-AoA Execution Activities**
- Publication of abstract of AoA in *Umm Al-Qura* (Official Gazette) or daily newspaper in KSA
- Secure lease for office space
- Inspection of office to ensure its suitability
- Secure Saudi *Iqama* for initial GM of Saudi LLC
- **Application for Commercial Registration ("CR")**
- Original executed AoA of Saudi LLC
- All Supporting Documentation (from SAGIA stage)
- Bank Certificate showing deposit of initial Share Capital
- Notice of Publication of AoA Abstract

Articles of Association

- **AoA is key official document governing rights of partners in and the operation of the Saudi LLC**
 - **Can provide for management by the Partners or a Board of Managers**
 - **Decisions by simple majority vote (unless a higher percentage is provided in the AoA)**
 - **But - Unanimous vote required for:**
 - **Change in nationality of the LLC**
 - **Any increase in liabilities of the Partners**

Shareholders Agreement (1)

- **Key private agreement governing the relationship of the Partners and operation of the Saudi LLC**
- **May "amplify" but not contradict the AoA**
- **Can be governed by law other than KSA law**
 - **But - Enforceability issues must be considered**
- **Most heavily negotiated agreement in JV context**

Shareholders Agreement (2) - Typical Clauses

- **Management Structure & Corporate Governance**
 - **Board Composition & Selection**
 - **Reserved Matters for Board & Partners**
 - **Supermajority Voting - for Board & Partners**
- **Capital Increases & Decreases**
- **Shareholder Loans**
- **Deadlock Provisions**
 - **May include Put & Call Options**
 - **But - beware enforceability issues under KSA law**
- **"Drag Along" & "Tag Along" Rights**
- **Governing Law & Dispute Resolution**

Other Key Agreements

- **Technology License Agreements**
 - Often with foreign parent company
 - Many governed by foreign law to better protect IP rights
- **Secondment Agreements**
 - For key technical and management personnel
- **Employment Agreements**
 - Must be tailored for Saudi law
 - Dual-employment considerations (pension plans etc.)

Financing the JV

- **Equity Capital Contributions by Partners**
- **Commercial Bank Financing**
- **Saudi Industrial Development Fund ("SIDF") Loans**
 - **For "industrial" projects (but not utilities operations)**
 - **Up to 50% of Total Project Costs**
 - **Maximum Loan Amount = SR 400 million**
 - **"Interest Free" - but some administrative costs for feasibility studies etc.**
 - **Secured by 1st lien mortgage on project assets**
- **Shareholders' Loans**
- **Public Investment Fund ("PIF") Loans**
 - **Must be \geq 10% KSA Government ownership in LLC**

Overview of Saudi Arabian Taxation

- **Saudi Arabian Income Tax Law (2004)**
 - **20% flat tax imposed on Net Income of foreign companies' activities in Saudi Arabia**
 - **Net Income determined using Saudi GAAP**
 - **2½% *zakat* (net wealth tax) imposed on Saudi investor's "net wealth"**
 - ***Zakat* Base computed using agreed formulae**
 - **GCC citizens also get *Zakat* treatment on KSA activities**
- **Saudi LLC is a "pass through" entity for tax purposes**
 - **Income Tax / *Zakat* computed at Partner level only although is usually paid by the Saudi LLC on their behalf**

Overview of Saudi Arabian Taxation

Tax Treatment of "mixed" Saudi-Foreign LLC

- **Example: ABC Saudi LLC is owned:**
 - 60% by Foreign Partner
 - 40% by Saudi Partner
- **ABC Saudi LLC generates SR 10 MM in Net Income**
 - Foreign Partner must pay Income Tax of SR 1.2 MM
(60% x SR 10,000,000 x 20%) = SR 1,200,000
 - Saudi Partner must pay *Zakat* of SR 100,000
(40% x SR 10,000,000 x 2½%) = SR 100,000

This disparate tax treatment often leads to disagreements between the Partners

Overview of Saudi Arabian Taxation

Withholding Taxes (under Income Tax Law)

- **Withholding Tax is payable by any Saudi entity on payments made to "non-residents" at these rates:**
 - **Management Fees - 20%**
 - **Royalties, Related Company Charges - 15%**
 - **Rental, Technical Services, Dividends, Loan Fees (Interest), Insurance Premiums - 5%**
 - **Any Other Payments - 15%**

Withholding Taxes must be taken into consideration when structuring JV arrangements with foreign companies

Overview of Saudi Arabian Taxation

Foreign Partner is subject to a 5% (Gross) Withholding Tax on all Dividends repatriated from Saudi Arabia.

In the above example, the Foreign Partner would be subject to net effective taxation of 24% of its Net Income from ABC LLC if it were to repatriate 100% of its SR 6,000,000 in Dividends outside KSA:

- **Income Tax on Dividends:**
 - **SR 10,000,000 x 60% x 20% = SR 1,200,000**
- **WHT on Repatriated Dividends:**
 - **SR 4,800,000 x 5% = SR 240,000**
- **Combined Total Tax:**
 - **SR 1,200,000 + SR 240,000 = SR 1,440,000**

Overview of Saudi Arabian Taxation - Tax Holidays

- **Tax Holidays were a common feature in Saudi foreign investment arena until 2000 when they were abolished**
- **10-Year Tax Holiday re-introduced in 2008 for investment in certain "underdeveloped" regions:**
 - **Jizan**
 - **Hail**
 - **Northern Border Region**
 - **Najran**
 - **Abha**
 - **Al-Jouf**

Overview of Saudi Arabian Taxation

It is important to understand Saudi Arabian taxation from the "macro" level in structuring JV arrangements in Saudi Arabia. Before finalizing such arrangements, however, the client should obtain tax guidance from a qualified tax advisor in Saudi Arabia, e.g.

- Ernst & Young
- Deloitte Touche
- PricewaterhouseCoopers
- KPMG

**Only a qualified tax advisor can legally provide tax advice
in Saudi Arabia**

Customs Laws

- **Saudi Arabia is member of GCC Customs Union**
- **General Rule: 5% Duty on all imported goods**
- **Protective Tariffs: Duty of 12% and 20% on import of certain goods that are also manufactured in a GCC state**
- **Equipment for Industrial Venture may be imported into Saudi Arabia on "duty free" basis**
- **Raw Materials & Semi-processed goods for Industrial Venture may also be imported "duty free"**
- **Goods manufactured in any GCC state (outside free zones) may be imported to any other GCC state on a "duty free" basis**

Saudization

- **The Saudi LLC will be subject to Saudization requirements in respect of its operations in KSA.**
- ***Nitaqat* (Zones) System - Implemented in May 2011**
 - **Companies now categorized into some 250 subsectors of the economy, with average Saudization rate determined for each**
 - **Companies above the average are in Green Zone (GOOD)**
 - **Companies at or below average are in Yellow Zone (PASS)**
 - **Companies well below average are in Red Zone (FAIL)**
 - **Green Zone Companies can recruit add'l foreign personnel**
 - **Red Zone companies lose recruitments and other labor rights**
 - **Yellow Zone companies must increase Saudization level or risk demotion to Red Zone the next year**

Thank you

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