Legal Advisors.

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in association with Baker & McKenzie Limited

Doing Business in Saudi Arabia

2016

An Outline of Various Forms of Doing Business in Saudi Arabia

2016

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Limited Liability Company

1. General

The locally incorporated limited liability company is one of the most common forms pursuant to which foreign companies do business in Saudi Arabia. The formation of a limited liability company is fairly involved. The Saudi Arabian General Investment Authority ("**SAGIA**"), which is the authority that is responsible for approving and licensing foreign investment in Saudi Arabia, must approve the formation of a limited liability company in which a foreign (non GCC)[1] party is to have an interest by granting a license authorizing the foreign party's investment in the company. SAGIA, in issuing the license, will also specify the objects which the company will be authorized to pursue. The parties must submit a joint application to SAGIA for this purpose prior to submitting the application. It is customary to enter into a joint venture agreement (if the shareholders are unaffiliated with one another) and agree upon the company's Articles of Association. After SAGIA grants the above-mentioned license the Articles of Association must be submitted to the Ministry of Commerce and Investment for its approval.

2. Features of a Saudi Arabian Limited Liability Company

Some of the more salient features of a limited liability company are:

(a) A minimum of one[2] and a maximum of fifty (50) shareholders may form the company. A corporate entity may be a shareholder and two affiliated foreign companies may form a Saudi company.

(b) The shareholders are liable for the debts of the limited liability company only to the extent of their capital shares.

(c) There is no minimum capitalization required by the Ministry of Commerce and Investment for companies wholly owned by Saudi and/or GCC investors.

(d) The minimum capitalization requirements set by SAGIA are SR[3] 25 million (US$ 6.67 million) for agricultural projects, and SR 1 million (US$ 267,000) for industrial projects, with no minimum capitalization for other projects, comprised of indivisible non negotiable shares of equal value. SAGIA and the Ministry of Commerce and Investment have the discretion to require larger capitalization. For example, the Ministry of Commerce and Investment generally follows a policy that manufacturing companies should be capitalized at an amount equal to 25% of the total anticipated cost of establishing the plant. Transfers of shares between the shareholders may be subject to such conditions and restrictions as are specified in the Articles of Association, but each shareholder is entitled by statute to a pre-emptive right.

(e) The company may be managed either by an individual manager or by a board of managers.

(f) Ten percent (10%) of the net profits of the company must be set aside as a statutory reserve until such reserve equals thirty percent (30%) of the original capital of the company.

(g) Under the Foreign Investment Regulations, companies incorporated in Saudi Arabia with foreign/non GCC participation should, in theory at least, be able to enjoy the advantages and incentives available to national companies. However, the Supreme Economic Council has a

[1] GCC: Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates).

[2] Until very recently a minimum of two shareholders was required for the formation of a limited liability company with the possibility for the two shareholders to be ultimately owned by the same group. The new Companies Law which entered into force on 2 May 2016 has allowed the formation of a limited liability company with a single shareholder.

[3] SR = Saudi Riyal

published "Negative List" of activities whereby certain activities are limited to wholly Saudi owned companies. This list is subject to periodic review and may be amended from time to time at SAGIA's recommendation. A translation of the current negative list is attached as Exhibit I hereto. Although most of the activities which are not mentioned on the negative list can be engaged in by companies that are up to 100% foreign-owned or by branches of foreign companies, certain activities may be undertaken only by companies having minimum Saudi ownership percentages and/or subject to other restrictions or requirements.

(h) GCC investors are generally treated like local investors and enjoy the advantages and incentives available to national companies, except for some specific activities (such as commercial agency activities) that are strictly restricted to Saudi nationals or Saudi companies wholly owned by Saudi nationals.

3. Advantages

(a) A limited liability company can sponsor its employees for residency purposes.

(b) A limited liability company undertaking an industrial project would, in most cases, qualify for financing from the Saudi Industrial Development Fund at favorable rates.

(c) A limited liability company may engage in the full range of activities which fall within the approved objects of the company and undertake projects in both the public and private sector. In addition, the company may promote and solicit business throughout the Kingdom.

4. Disadvantages

(a) The activities of the limited liability company are limited to the objects approved by the Ministry of Commerce and Investment or SAGIA (as the case may be) and set forth in its Articles of Association. The objects must be broad enough to allow the company to engage in the activities it wishes to, but if too broad SAGIA is unlikely to approve them. From the viewpoint of a foreign company having a Saudi partner, the objects of the limited liability company should be broad enough to allow the company to engage in the activities it wishes to, but should be narrow enough to allow the foreign company the option of forming another limited liability company or branch having different objects within the same general area of endeavour.

(b) Unless the other partner is an affiliate, the foreign partner will not have complete control over the management of the company or the treatment of its employees.

(c) The dissolution process can be fairly involved and, if a partner chooses not to be cooperative, costly. The commitment should therefore be viewed as a long term one and partners very carefully chosen.

(d) Initial capitalization is required and may be quite large depending upon the objects of the company.

(e) When a foreign company is participating in a limited liability company with a Saudi partner SAGIA's general policy is not to permit the foreign company become a partner in another company or form a branch with similar or overlapping objects.

(f) With respect to companies without Saudi participation, see comment (3)(d) below in the section on branches.

Branch

1. General

(a) The Companies Regulations and the Foreign Investment Regulations permit a foreign company to establish a branch in Saudi Arabia, subject to approval by SAGIA. In order to obtain a license to form a branch, a foreign company must submit an application to SAGIA, however, branches of companies wholly owned by GCC nationals only require the approval from the Ministry of Commerce and Investment. The formation process is generally similar to that of a limited liability company except that there are no Articles of Association to be approved. However, the Minister of Commerce and Investment, under the Companies Regulations, must issue a decision approving the formation of the branch. The capital requirements are the same as that of a limited liability company and dependent on what type of activity the proposed branch will undertake. Also like a limited liability company, ten percent (10%) of the net profits of the branch must be set aside as a statutory reserve until such reserve equals thirty percent (30%) of the original capital of the company.

2. Advantages

(a) The formation process is generally simpler than for a company. For example, no Articles of Association have to be approved. However it can sometimes take a bit longer to form than a company if the manager is not a Saudi/GCC national or a foreign national who is already a Saudi resident because a foreign manager who is not already a Saudi resident must obtain a residence permit as part of the formation process. In the case of a company it may or may not be necessary to obtain a residence permit during the formation process, depending on the company's ownership and management structure.

(b) A branch may engage in the full range of activities which fall within its approved objects and undertake projects in both the public and private sector. In addition, the branch may promote and solicit business throughout Saudi Arabia.

3. Disadvantages

(a) Since a branch has no separate and independent legal personality, a foreign company operating in Saudi Arabia through a branch could be subject to suit in its home country in connection with a claim arising out of its in-Kingdom activities.

(b) Like a limited liability company, a branch's activities are limited to the licensed objects which have been approved by SAGIA or the Ministry of Commerce and Investment (as the case may be) and may not include activities on the "negative list" (see Exhibit I). Moreover, certain activities recently removed from the negative list may only be undertaken by companies having minimum Saudi ownership percentages and these of course may not be undertaken by branches. It should be noted that branches are normally licensed (and expected) to engage in substantive, income-producing work. Branches cannot be formed solely to engage in promotional activities, but have from time-to-time been formed for the purpose of providing liaison and managerial and technical support functions for joint venture companies in which the foreign company (or its affiliates) participate.

(c) Also like a limited liability company, a branch of a foreign company must be capitalized at a level set by SAGIA. Unlike a limited liability company, however, there are no other shareholders to share the financial burden of providing the minimum capital for the branch and of setting up a commercial and administrative infrastructure in the Kingdom.

(d) As a practical matter, it can be difficult to function in Saudi Arabia without a Saudi partner to help handle something as mundane as expediting the issuance of exit and re-entry visas, or as significant as helping one find his way through the upper echelons of a Saudi Ministry. A branch therefore does not guarantee complete freedom of action from the practical (and oftentimes political) necessity of having a close working relationship with one or more Saudis. That relationship could, however, take the form of an agency or consulting relationship.

Technical Scientific Services Office ("TSO")

1. General

Only foreign pharmaceutical companies are legally required to establish a TSO. Non-pharmaceutical companies, however, have been able to form TSOs at the discretion of SAGIA and the Ministry of Commerce and Investment, provided that, in the opinion of those authorities, the products of the company are sufficiently complex to justify establishing the TSO. The process of forming a TSO is similar to that of forming a branch, however, it would also require the foreign company to enter into a distributorship agreement with a Saudi distributor which is required to be registered as such with the Ministry of Commerce and Investment under the Commercial Agencies Law. Moreover, approval from the Saudi Food and Drug Administration is required in order to establish a TSO in the pharmaceutical or medical device fields.

A TSO serves, in essence, as a liaison between a foreign company, its Saudi distributor and the local market. A TSO cannot engage in commercial activities or earn revenue. Its activities are limited to: (i) providing technical information and assistance regarding the foreign company's products to the distributor and to end users of the products, including analyzing and assisting the distributor to handle technical service problems; (ii) studying the market and preparing reports to the company's head office; and (iii) conducting technical research in connection with the products.

2. Advantages

(a) Formation process is simpler than for a company and is similar to that of a branch.

(b) There are no capital requirements.

(c) The TSO may bring its employees into Saudi Arabia on visas it may obtain, thereby retaining full and complete control over its employees.

3. Disadvantages

(a) The TSO could not be involved in any fee earning work and would be expected to act as a liaison office and support center for the locally appointed Saudi distributor.

(b) A TSO would not have a separate and independent legal personality; therefore, a foreign company operating in Saudi Arabia through a TSO could be subject to suit in its home country in connection with a claim arising out of its in-Kingdom activities.

(c) A TSO would not have licensed objects like a branch and therefore could not perform services outside of local promotion and support for its agent.

(d) A TSO is limited to the number of employees it could employee which would ordinarily be limited to five (5) or less non-Saudi nationals initially and perhaps ten (10) such persons even after a period of time. The exact number would subject to approval by Saudi authorities. In the case of a TSO in the pharmaceutical field the manager of the TSO must be a Saudi pharmacist.

(e) The distributor must write a letter supporting the establishment of the TSO.

Temporary Commercial Registration ("TCR")

1. General

A TCR permits a foreign company to do business in Saudi Arabia in only a very limited sense and has only been available to companies having a government contract. TCRs have not in most cases been available in connection with subcontracts on government projects although some exceptions have been made.

If a foreign company is a prime contractor it must first obtain a Temporary License from SAGIA, before it files an application for a TCR with the Ministry of Commerce and Investment. In general the formation process is similar to that of a branch.

The TCR will enable the foreign company to perform the government contract, but the company may only engage in activities directly related to the performance of that contract. The foreign company may not engage in the general promotion or solicitation of business. Moreover, the term of a TCR is limited to the term of the contract with regard to which it is granted.

2. Advantages

(a) There is no capitalization requirement.

(b) The TCR need not (and in fact cannot) be applied for until a contract has actually been obtained.

(c) A TCR can be obtained for consulting projects.

3. Disadvantages

(a) A foreign company may only obtain a TCR after it has obtained a government contract and the license is limited to the scope and duration of the contract only.

(b) A TCR does not allow a foreign company to establish an actual presence in the Kingdom for the purposes of promoting business, or even simply monitoring and surveying market conditions and business opportunities. The company must therefore rely on business opportunities brought to its attention by third parties or identified by its in-Kingdom personnel.

Exhibit I - Negative List

The following is a list of activities approved by the Supreme Economic Council in which foreign investment is excluded. This list will be reviewed every year with the aim of opening some sectors to foreign investments.

List of Activities Excluded from Foreign Investment

<u>Industrial Sector</u>

1. Oil exploration, drilling and production. Except the services related to mining sector listed at (CPC 5115 + CPC 883) in International Industrial Classification codes.

2. Manufacturing of military equipment, devices and uniforms.

3. Manufacturing of civilian explosives.

Service Sector

1. Catering to military sectors.

2. Security and detective services.

3. Real estate investment in Makkah and Madina.

4. Tourist orientation and guidance services related to Hajj and Umrah.

5. Recruitment and employment services including local recruitment offices.

6. Real estate brokerage.

7. Printing and publishing. Except the following activities:

   (a) Pre-printing services internationally classified at CPC 88442.

   (b) Printing presses internationally classified at CPC 88442.

   (c) Drawing and calligraphy internationally classified at CPC 87501.

   (d) Photography internationally classified at CPC 875.

   (e) Radio and television Broadcasting Studios internationally classified at CPC 96114.

   (f) Foreign media offices and Correspondents internationally classified at CPC 962.

   (g) Promotion and Advertising internationally classified CPC 871.

   (h) Public relations internationally classified at CPC 86506.

   (i) Publication internationally classified at CPC 88442.

   (j) Press services internationally classified at CPC 88442.

   (k) Production, selling and renting of computer software internationally classified at CPC 88.

   (l) Media consultancies and studies internationally classified at CPC 853.

   (m) Typing and Xeroxing internationally classified at (CPC 87505 + CPC 87904).

   (n) Motion picture and video tape distribution services internationally classified at CPC 96113.

8. Commission agents internationally classified at CPC 621.

9. Audiovisual and media services.

10. Land transportation services, excluding the inter-city passenger transport by trains.

11. Services provided by midwives, nurses, physical therapy services and quasi-doctoral services internationally classified at CPC 93191.

12. Fisheries.

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