

Doing Business
in
Saudi Arabia

DOING BUSINESS IN SAUDI ARABIA

Contents

	<u>Page</u>
Preface	
General Information	1
Geography and climate	
Population and language	
Government	
Currency and foreign exchange regulations	
The calendar and international time zone	
Business hours	
Public holidays	
The Economy	4
General	
Basic resources	
Principal industries	
Banks	
Other financial institutions	
Stock exchange	
Investment Regulations and Incentives	7
General	
Regulations governing foreign investment	
Business incentives	
Company Law	9
General	
Business entities	
Legal structures allowed to foreign investors	

	<u>Page</u>
Establishing a Business Presence	12
Licensing and registration Sponsorship, agencies, government contracts, branch and representative offices Intellectual property laws Other formalities	
Labor Law and Social Insurance	14
General Labor relations Working hours, holidays and vacations Termination of employment Pay rates, overtime and bonuses Social insurance	
Imports and Custom Duties	16
General policy Imports Customs duties	
Accounting and Auditing	17
The profession Standards and reporting Accounting periods Accounting records	
Taxation	19
General Zakat Income tax Income tax rates Withholding tax Other taxes Administration of tax Dividends Supply contracts Deduction of expenses Treatment of losses Group taxation Taxation of branches of foreign companies	
Example : Corporate Income Tax Calculation	26

PREFACE

This profile on doing business in Saudi Arabia has been prepared by Dr. M. Al-Amri & Co. the member firm of Baker Tilly International in Saudi Arabia. The profile is designed to provide information on a number of subjects important to those contemplating investment or doing business in Saudi Arabia.

Economic policy in Saudi Arabia generally welcomes foreign investment, evidenced by the various government and tax incentives discussed in this profile. Foreign investors, however, are subject to a number of government regulations and tax laws. This profile provides, in condensed form, a summary of the rules, regulations, and tax laws that could affect the foreign investors.

This profile is a general guide to the regulatory and tax aspects of investments or business activities in Saudi Arabia and does not purport to be an exhaustive reference source. The decision making process concerning foreign investment is a complex exercise and the commercial environment of a country continually changes. If you are a foreign investor contemplating investment or doing business in Saudi Arabia, you should obtain up-to-date detailed advice and consult with your financial and tax advisor.

Should you require further information or advice on the subject of doing business in the Kingdom, Baker Tilly International's member firm in Saudi Arabia will be pleased to assist.

Baker Tilly International is one of the leading firms of public accountants and tax and management consultants in the world. The firm's network comprises over 17,000 staff in 480 offices around the globe. This guide is one of a series of country profiles compiled for use by Baker Tilly International's clients and professional staff which may be obtained from any of our international offices or, within the Kingdom of Saudi Arabia, from Dr. M. Al-Amri & Co.

Every care has been taken in the preparation of this profile which has been compiled from various documents and other reference sources of information available. Nevertheless this material may contain errors and omissions for which Baker Tilly International cannot assume responsibility.

GENERAL INFORMATION

Geography and climate

The Kingdom of Saudi Arabia is the largest country in the Arabian Peninsula and occupies some 2.3 million square kilometers (865,000 square miles). It is bounded to the west by the Red Sea; to the north by Jordan, Iraq and Kuwait; to the east by the Arabian Gulf, the United Arab Emirates, Qatar, and Bahrain, and to the south by the Sultanate of Oman and Yemen . Much of the country is desert.

The Kingdom is divided into four principal regions:-

The Western Region (Hejaz) which borders the Red Sea and in which the major sea port of Jeddah, the industrial city of Yanbu and the Muslim Holy Cities of Makkah and Medina are situated.

The Central Region (Najd) which is situated on the central plateau is the largest of the provinces and contains the capital, Riyadh, the seat of government.

The Eastern Region (Al Hasa) in which the three closely situated cities of Al Khobar, Dhahran and Dammam comprise the regional centre, contains the industrial city of Jubail (twin of Yanbu in Western Province) and the oil port of Ras Tanura. The Kingdom's principal oil reserves and associated installations are located in this region.

The Southwest Region (Asir) has some agriculture but is predominantly a mountainous region bordering Yemen.

Whilst the climate in Saudi Arabia is mainly warm and dry, variations occur between the coastal areas and the interior regions.

Riyadh, being far inland has a continental climate, i.e. much hotter than Jeddah in mid summer but colder in mid winter. Temperature in the capital in June, July and August can reach 49 C (120 F) in the shade and average about 13 C (55 F) from December to February dropping to near freezing point at night. Humidity is low and therefore less tiring than that of the coastal cities.

The Western province climate is similar to that of Riyadh but with higher humidity.

The coastal areas are cooler with high humidity where as the interior regions are warm most of the year.

Population and language

Based on the last official census the Kingdom has a population of 21 million including 4.6 million expatriates from different parts of the world.

Arabic is the official language of the Kingdom. Whilst English is widely spoken in business and government circles, all correspondence with the government authorities is conducted in Arabic.

Government

The Kingdom of Saudi Arabia is a stable monarchy. The head of state, King Abdullah bin Abdul Aziz Al-Saud, whose official title is the Custodian of the Two Holy Mosques, succeeded to the throne in 2005 on the death of King Fahad.

The head of state, King Fahad bin Abdul Aziz Al-Saud, whose official title is the Custodian of the Two Holy Mosques, succeeded to the throne in 1982 on the death of King Khalid.

The King, who is the present prime minister and a Council of Ministers form the executive and legislative branches of the Government responsible for formulating the country's economic policy and guiding development. The Council of Ministers is supported by a Consultative Council "Shura" which has 150 distinguished men of the Kingdom as its members appointed by the King. Being the cradle of Islam, the Kingdom's legal system and laws are based on "SHARIA" Islamic principles. The laws and regulations applicable to all businesses are promulgated by Royal Decrees. Their interpretation and implementation procedures are encoded in Ministerial Resolutions, issued from time to time. The Kingdom is divided into 13 provinces, the administration of which is presided over by governors.

Currency and foreign exchange regulations

The unit of currency is the Saudi Riyal (SR) which is divided into 100 subunits called hilala. There have been small adjustments from time to time in the exchange rate between the Saudi Riyal and the US dollar. In 1986 the exchange rate was set at SR 3.75 to US\$ 1.00. Capital and income are allowed to be repatriated and personal savings and management fees remitted abroad without restriction.

The calendar and international time zone

The Hijra calendar is the official calendar of Saudi Arabia and is based on lunar change. The calendar has 12 months of 29 or 30 days each, and accordingly is ten or eleven days shorter than the Gregorian calendar year. This results in the religious holidays occurring at different dates each year according to the Gregorian calendar. The year 2004 (Gregorian) is roughly equal to 1425 (Hijra).

Saudi Arabia is three hours ahead of Greenwich Mean Time and eight hours ahead of U.S. Eastern Standard Time.

Business hours

The week commences on Saturday and extends through Thursday, Friday being the day of rest. Government offices are closed on Thursdays.

Private Sector and Government office hours vary between business, cities and government departments but may broadly be summarised as follows :

Government :	7.30 to 14.30
Private sector :	8.00 to 17.00
	or
	8.00 to 13.00 and
	17.00 to 20.00

Public holidays

There are two official holidays each year which represent religious festivals, the dates of which vary from year to year. The holidays are:

Eid Al-Fitr - a four to five day holiday occurring at the end of the holy month of Ramadan.

Eid Al-Adha - a six to eight day holiday occurring at the end of the Hijra year approximately two months after Eid Al-Fitr.

Airports tend to be extremely busy during these times, especially around Eid Al-Adha when around two million Muslims perform the pilgrimage (Haj) to Makkah.

THE ECONOMY

General

Saudi Arabia since the discovery of its oil in 1938 has grown to be amongst the wealthiest nations of the world. The Kingdom has the largest proven oil reserves in the world outside the United States and the Soviet Union. The considerable increase in world oil prices in 1973 quadrupled oil revenues and enabled the Kingdom to embark upon a massive development program. The diversification strategy of the Kingdom, especially through enhancement of the private industrial sector has paid dividends in expanding the economy by broadening the industrial base.

Basic resources

Crude Oil has traditionally been the main source of Saudi Arabia's income over the last 40 years and currently accounts approximately for 80 to 85 percent of export earnings. The Kingdom has become a major force in the international petrochemicals market through the additional utilization of its massive gas reserves. The Kingdom claims to produce more than 5 percent of the total production of petrochemicals in the world. Agricultural development continues to make substantial strides forward. The substantial rise in the production of meat, poultry, vegetables and fruit has considerably reduced the Kingdom's dependence on imports of these items.

Principal industries

The oil and gas industry remains vital to the economy of Saudi Arabia. The growth of the private sector, however, has made a significant contribution to the economic diversification strategy of the Kingdom, resulting in a substantial increase of that sector's share of the Gross Domestic Product over the years.

The principal industries in place and operating lie either at the heavy industrial end, such as :

- oil and gas downstream facilities;
- iron and steel plants;
- base and intermediate chemical plants;
- fertilizer plants;

or at the light end of manufacturing :

- a whole range of consumer products;
- food products;
- paints;
- detergents;
- light to heavy building material products (including fabricated aluminum items and cement products);
- plastic products;
- engineering items such as air conditioners and circuit breakers.

The development of Saudi Arabia's twin industrial cities, Jubail on the Gulf and Yanbu on the Red Sea, has been one of the keystones of industrial policy for the last two decades. Jubail in its primary industry park has approximately 25 large capital intensive industries in petroleum products, petrochemicals, fertilizers and metal. The secondary industries park has a wide range of intermediate and end-product private sector plants.

In its primary industry park, Yanbu houses two major petrochemical complexes, an export refinery, a domestic refinery and a natural gas liquefaction plant. In the secondary industries park there are lube oil refineries and other lube additives and blending plants, an export unit for the paints intermediate, titanium dioxide, and several other large manufacturing plants.

The Saudi agricultural sector continues to be an important one with the introduction of modern farming methods and the construction of storage and cold storage facilities.

Banks

There are over ten commercial banks with hundreds of branches operating in all the major cities of the Kingdom.

Four of these banks are wholly Saudi owned and the others either represent major international banks or joint ventures with major international banks of the world. Bank lending consists mainly of trade and medium-term investment finance. Banking operations in the Kingdom are regulated by the Saudi Arabian Banking Control Law and are supervised by the Saudi Arabian Monetary Agency (SAMA).

There are no prohibitions on the lending of funds by non-Saudi banks to Saudi entities and many businesses do borrow from international banks. Lending by Saudi banks to foreign entities is only permitted with prior approval from SAMA.

Other financial institutions

Public sector institutions

There are mainly three specialised public sector credit institutions which provide loans to Saudi individuals and companies :

- Public Investment Fund (PIF)
- Saudi Industrial Development Fund (SIDF)
- Saudi Arabian Agricultural Bank (SAAB)

The PIF, established in 1971, provides funds only for government or mixed (government / private) domestic industries suitable for public sector participation.

PIF has been the major funding agency for the base chemical and heavy industrial plants and for the export refineries. PIF's loans are generally long-term and on very soft terms.

Private industry is financed mainly by SIDF, which comes under the Ministry of Finance and National Economy. Since its inception in 1974 the Fund has maintained its support to national industry at large and has been the prime mover in encouraging the private sector to invest in manufacturing enterprises. SIDF loans amount to up to 50 percent of project cost, are long term and at low cost.

The Saudi Arabian Agricultural Bank is an important source of finance to the agricultural sector.

Private sector institutions

In the private sector there are three main industrial groups providing funding and taking equity participation.

- . National Industrialisation Company (NIC)
- . Saudi Advanced Industries Company (SAIC)
- . Saudi Venture Capital Group (SVCG)

The NIC operational from 1985, has been organised to stimulate private industrial development in the Kingdom. NIC seeks joint venture project proposal from companies who may be interested in 20-40 percent equity participation in new industrial joint ventures in Saudi Arabia.

SAIC, a public company, was established in 1986 for the purpose of participation in joint venture projects employing advanced industrial technology. The company has participated in the formation of various aerospace industrial projects and seeks investors with technical know-how for investment in new industrial projects in Saudi Arabia.

The SVCG, a loose grouping of about forty influential senior Saudi businessmen and industrial families, is an important organization and a response to the government's thrust to bring the private sector into industrial development.

Stock exchange

In terms of total capitalization, the Saudi Stock Exchange (Tadawul) is the largest in the Middle East. Privatization of public entities has long been a top priority of the Saudi Government. The privatization of public entities such as Saudi Telecommunications and Saudi Electricity in the recent past has set a healthy trend of a larger number of organizations seeking listing on the Saudi Stock Exchange.

In order to strengthen the Saudi Capital markets, the government set up the Capital Market Authority (CMA) in 2003 pursuant to the Capital Market Law. The CMA is entrusted with the organization and development of the capital market in the Kingdom through enactment and enforcement of the rules and regulations for protection of investors and integrity and stability of the stock exchange.

INVESTMENT REGULATIONS AND INCENTIVES

General

Saudi Arabia is a country rich of potential business and investment opportunities. The Kingdom's broad economic goals are to transform its oil based economy into a broadly based and privately owned industrial and service economy.

Achieving these goals require a steady flow of investment coupled with technology and expertise into the country. The government policy is, therefore, designed to encourage the investment of foreign capital, particularly in economic development projects. The government's established foreign investment policy assures investors that it will refrain from imposing any restrictions on the flow of money into and out of the Kingdom.

The following areas, which are considered essential to the Kingdom's current and future economic growth, are being promoted by the government and involve foreign company participation :

Import-substitution and export oriented ventures.

Projects contributing to technological progress in the Kingdom and the development of already established factories through improvement of production methods and minimization of production costs.

Projects directly related to the current economic development in the Kingdom. Such projects include, but are not limited to the following :

- Industries utilizing locally abundant raw materials derived from the petrochemical or petroleum sectors.
- Food industries utilizing locally abundant agricultural products.
- Specialized industries in the fields of maintenance and the manufacturing of spare parts and equipment.

Regulations governing foreign investment

Business undertakings involving foreign capital are regulated by Foreign Investment Regulations which were issued in April 2000 as part of the government's ongoing drive to liberalize its foreign investment policy. These regulations superceded the Foreign Capital Investment Code issued in 1979.

Under these Regulations, the Saudi Arabian General Investment Authority is authorized to issue licences for any temporary or permanent foreign investment in the Kingdom.

A foreign investor is allowed to obtain more than one license for various business activities. Projects licensed under these Regulations enjoy all the privileges, incentives and guarantees available to a national project.

A business entity licensed under these Regulations is allowed to own real estate required for carrying out its business operations or for providing housing facilities to its employees. Moreover, the sponsorship of the foreign investor and his non-Saudi personnel is entrusted to the business entity licensed under these Regulations.

Business incentives

Incentives provided to encourage foreign investment in approved industrial and non industrial projects include the following :

Lower taxation rates.

Exemption of exports from customs duties.

Exemption from customs duties on machinery, equipment, tools and spare parts imported for industrial projects.

Exemption from customs duties on primary raw materials, semi finished goods, containers, etc; necessary for industrial projects (provided that similar items are not sufficiently available locally).

Loans and equity participation on favorable terms.

Financial and technical operating subsidies.

Provision of land at favorable rents for industrial projects.

No restriction on repatriation of profits.

COMPANY LAW

General

The formation and operations of business entities in Saudi Arabia are regulated by the Companies Law promulgated by a Royal Decree in 1965, as amended in 1967 and 1982 by subsequent Royal Decrees. The provisions of the Companies Law are extensive and cover all types of commercial activities in the Kingdom.

Business entities

The companies Law recognizes mainly eight types of business entities which are :

- General partnership
- Limited partnership
- Partnership limited by shares
- Limited liability company
- Variable capital company
- Joint stock company (corporation)
- Cooperative company
- Joint venture

As mentioned below increasing encouragement is being given for foreign investment to take the form of joint stock companies or limited liability companies, as many of the other forms require a degree of unlimited liability and are thus less appealing.

Other forms of foreign investment however include representative offices and agencies and these are discussed more fully in 'Establishing a Business Presence' section of this profile. A foreign investor is also allowed to set up a branch in the Kingdom.

This plethora of different forms of enterprises may broadly be explained as follows:

General partnership

A general partnership, also known as "joint liability partnership", consists of two or more partners who are jointly and severally liable for the debts of the partnership to the full extent of their assets.

Limited partnership

A limited partnership, also known as "mixed liability partnership" consists of at least one general partner who is liable for the debts of the partnership to the full extent of his assets and at least one partner who is liable only to the extent of his capital contribution. A limited partner may not take part in external acts of management.

Partnership limited by shares

In this form of limited partnership, which must have at least one general partner and four limited partners, the interests of the limited partners consist of negotiable shares of equal value, the value of each share being Saudi Riyal SR 50 or more. The minimum share capital must not be less than SR 1,000,000, 50% or more of which is required to be paid in upon formation.

Limited liability company

A limited liability company, also referred to as "limited liability partnership or a Saudi limited liability company" is a private entity formed of two or more partners who are liable for company debts to the extent of their contributed capital. A maximum of 50 partners are allowed in such a company. The total share capital must be SR 1,000,000 or more, divided into non-negotiable shares of equal value.

The company may not include in its objects the conduct of banking, insurance or savings. Inter alia, requirements are placed on the company in respect of audits, annual general meetings and filing of accounts. The company is required to transfer 10% of net profits each year to a legal reserve until such reserve reaches a level of 50 percent of the paid-up share capital, and an extra ordinary general meeting must be called if accumulated losses have eroded the share capital by 75% or more, to consider dissolving the company.

Variable capital company

As the term implies, the capital of such a company may be varied in accordance with company's Memorandum and Articles of Association. The capital may be increased either by further contributions from the existing partners or by the admission of new partners, and it may be reduced either by the withdrawal of partners or by reduction of their capital.

Joint stock company

A joint stock company or corporation consists of five or more shareholders who are liable for the debts of the company to the extent of their capital contribution. The company may be incorporated only upon the approval of the Minister of Commerce or upon the issuance of a Royal Decree. The share capital must not be less than SR 2,000,000, or SR 10,000,000 if the public is invited to subscribe, and it must be divided into shares of equal value with a par value of SR 50 or more. At least 50% of the capital is required to be paid in upon incorporation. Similar requirements to those in respect of a limited liability company apply in respect of audits, annual general meetings, legal reserves, filing of accounts and erosion of the capital base.

Cooperative company

A limited liability company or a joint stock company may be incorporated as a cooperative for the purposes of achieving specific objects such as reductions in the cost, the selling price of certain products and services or improvements in their quality. Capital is variable and it must be divided into shares of equal value with the par value of each share ranging from SR 10 to SR 50.

Joint venture

A joint venture in Saudi Arabia is not considered as a juristic entity. It is an association of two or more persons which is not made known to third parties. Third parties, therefore, have recourse only against the joint venturer with whom they had business dealings. A joint venture is not subject to the publication requirements applicable to other forms of business entities. This form of business structure is different from the term " Joint Venture " used as common business practice within the Saudi community which is more often than not really a limited liability partnership with foreign participation.

Legal structures allowed to foreign investors

For foreign investors wishing to engage in business in Saudi Arabia there is, therefore, a wide range of legal structures available, although it is necessary to obtain permission for each type from the relevant government bodies. If the business involves commercial activities in Saudi Arabia, it is necessary to have a company or branch in the Kingdom, but for public sector contractors there are special rules.

As mentioned above, foreign businesses are increasingly being encouraged to opt for the joint stock company (corporation) or the limited liability company form in cooperation with Saudi partners.

The rationale behind this is the Government's wish to see foreign businesses making a more permanent commitment to the Kingdom in situations likely to lead to the transfer of expertise and technology.

The joint stock company is generally only available when it is envisaged that shares will be issued to the general public in the future. This has been applied to banking and ventures involving the exploitation of natural resources. In such cases the joint stock company is the recommended form. For most investors, however, the limited liability company is the practical form of local incorporation.

As stated above foreign companies wishing to do business in the Kingdom may also set up a branch which as with most other forms of foreign investment falls within the scope of the Foreign Investment Regulations. The branch is also subject to the regulatory authority of the Ministry of Commerce.

ESTABLISHING A BUSINESS PRESENCE

Licensing and registration

The establishment of business presence in the Kingdom by a foreign company or an individual whether in the form of a wholly owned subsidiary company, a Saudi Limited Liability Company, partnership etc; requires an investment license under the Foreign Investment Regulations from the Saudi Arabian General Investment Authority (SAGIA).

Provided all documentation is complete at the time of submission of the application, the SAGIA is required to evaluate the investment request and give its decision within 30 days. If this period elapses without a decision by the SAGIA, it is obliged to issue the required licence to the investor.

If an application is turned down by the SAGIA within the 30 day period, it must give reasons for its decision. The applicant has the right to appeal against the SAGIA's decision.

In order to ensure that the licensing process is made efficient, the SAGIA has set up an Investors Service Center (ISC) as a one window operation to eradicate all bureaucratic red-tape.

All applications for new licenses or for modification of existing ones are now processed through the ISC. In addition, the ISC provides the following services to potential investors:

- Provides information to potential investors on the investment opportunities in the Kingdom as well as guidance on applicable rules and regulations, such as Foreign Investment Regulations, Corporate Law, Labor Law, Income Tax Regulations etc.

- Assists applicants in completing the necessary forms and fulfilling the documentary requirements.

- Provides post-licensing services to prospective investors, through representatives of various government ministries based at the SAGIA, in obtaining all the necessary permits and approvals required to commence operations, such as the company's registration in the Companies Register and obtaining Commercial Registration Certificate from the Ministry of Commerce.

Sponsorship, agencies, government contracts, branch and representative offices

In addition to the aforementioned legal business entities, a foreign company or an individual can undertake business in the Kingdom through a Saudi sponsor or agent, as a branch office or as a representative office for liaison of its operations in the Kingdom. All of these activities are governed by various specific government regulations. A sponsored company cannot have its own legal presence in the Kingdom. The functions of a sponsored company are restricted to the supply of goods or services including supply of personnel to the sponsor provided those personnel are paid directly by the sponsor.

The commercial agencies are regulated under the Commercial Agency Regulations. These Regulations explain the rules, rights and obligations of commercial agents and distributors.

The law governing the relationship between foreign contractors engaged on government contracts and their Saudi agents was repealed in 2001. Under the old law, a foreign contractor engaged on a government contract, who did not have a Saudi partner, was required to appoint a Saudi national or a company as his agent. The function of the Saudi agent was to represent the foreign contractor for activities such as bidding for government contracts, obtaining work permits and visas from relevant government departments etc.,. The Saudi agent was entitled to a maximum fee of 5% of the contract value under the old law.

Now foreign contractors and companies who wish to pursue government contracts can operate in the Kingdom without a Saudi agent by opening offices or appointing representatives.

Intellectual property laws

Intellectual property law consists of three areas: patents, trademarks, and copyrights. Each of these is governed by different set of rules.

The patent regulations provide fairly comprehensive legislation on the issue, registration, duration, cancellation etc, of patents in the Kingdom. Under these regulations the King Abdul Aziz City for Science and Technology has the sole jurisdiction to issue patents.

The rights created by the patent are confined to the field of industrial activities and do not include activities conducted for the purpose of scientific research. The patent rights are valid for 15 years from the date of issue of the patent and may be renewed for another five years at the request of the patent holder. Within two years from the date of issue of the patent, the patent holder must ensure full industrial exploitation of the patent in the Kingdom. This period may be extended for a maximum of two years provided the request is based on valid reasons. The disputes pertaining to patents are within the jurisdiction of a committee established for this purpose by a resolution of the Council of Ministers.

Trademarks in the Kingdom are governed by the Trademarks Regulations. These regulations explain the procedures for registration, announcements, renewal and deletion, transfer of ownership and licensing of trademarks. In addition they define crimes and penalties regarding trademarks to protect public and private rights.

Copyrights period of protection varies and depends on the type of work. In 1997, Saudi Arabia joined the Universal Copyright Convention and the Berne Convention on copyrights protection. This means that foreign-owned copyrights will receive the same protection under the Saudi law as the Saudi.

Other formalities

Newly formed business entities are required to notify their formation to the Department of Zakat and Income Tax and the General Organization for Social Insurance. Additionally, registration with the local Chamber of Commerce is mandatory in the Kingdom.

LABOR LAW AND SOCIAL INSURANCE

General

The Labor and Workmen Law regulates all matters relating to Labor in the Kingdom.

Labor relations

The Labor Law does not allow the formation of labor and trade unions in the Kingdom. Disputes between employers and employees are referred to the "Commission for Settlement of Disputes " which has the exclusive jurisdiction to render decision on such matters. The law provides for inspection of business premises by inspectors from the Ministry of Labor to ensure compliance with the provisions of the Labor and Workmen Law.

Working hours, holidays and vacations

The law stipulates the maximum working hours to be 8 per day or 48 hours per week in all months of the year with the exception of Ramadan (the Muslim holy month of fasting) when the maximum number of working hours are restricted to 6 per day or 36 hours per week. In the case of businesses such as hotels, restaurants, seasonal enterprises and where approval has been granted by the Minister of Labor, the maximum number of daily working hours may be increased to nine. Similarly the number of daily working hours may be reduced for people employed in industries or operations classified as hazardous or harmful by the Minister of Labor.

Friday is the weekly holiday in Saudi Arabia as it is in most other Muslim countries. Presently there are 10 days of public holidays each year. In addition to these public holidays employees are entitled to a minimum of 15 days vacation after one year of service or 21 days after three years of service. However, the normal practice in the Kingdom is 30 days annual vacation in addition to the public holidays.

Termination of employment

A labor contract entered into for a specified term terminates upon the expiry of its term. If both parties mutually agree to apply the contract thereafter then it is deemed to have been renewed for an unlimited duration. Contracts of unlimited duration may be cancelled for a valid reason by either party to the contract provided a 30 days prior notice is given if the employee is paid monthly. For other employees a 15 days prior notice is necessary.

On the expiry of specified-term contracts or the termination of unlimited duration contracts by employers, employees are entitled to a service award of half a month's salary for each of the first five years of service and one month's salary for each year thereafter. The current rate of pay is taken as the basis for computation of the service award. If an employee with an unlimited duration contract resigns, he is entitled to one-third of the specified-term award if his period of service is between two and five years; it is two-thirds of the specified-term award if his service period is more than five and less than ten years; and the full specified-term award if his service period is more than ten years.

Pay rates, overtime and bonuses

The rates of pay in the Kingdom vary considerably from industry to industry and between nationalities.

The Labor Law provides for the minimum overtime rate as 150% of the normal rate. Bonuses are payable at the discretion of the employer. It is, however customary for banks and petrochemical companies to give their staff annual bonuses.

Social insurance

Social insurance in the Kingdom is administered by the General Organization for Social Insurance. Employers are required to make contribution at the rate of 9% of salary (including benefits in kind) for Saudi employees who are required to contribute same percentage of their salary in respect of social insurance. In addition, employers are required to contribute 2% of the basic salary of both Saudi and non-Saudi employees to cover the job hazards risk.

Certain categories of employees such as certain government employees, armed forces and diplomatic personnel, domestic servants etc are exempt from social insurance contributions.

IMPORT AND CUSTOM DUTIES

General policy

Saudi Arabia is dedicated to the concept of the Free Market and on the whole, pursues a liberal trade policy. Generally, there are no price or quantity restrictions on imports of goods into the Kingdom except for alcohol and pork products which are prohibited under Islamic SHARIA Law. The importation of fire arms is also prohibited under Saudi law. Imports of items such as plants, fruit, vegetables, seeds, live animals and poultry require prior approval from the appropriate Saudi authorities. The import of medicines and pharmaceutical products into the Kingdom requires a license from the Ministry of Health.

Imports

Although Saudi Arabia's imports have declined due to its policy of import substitution, the Kingdom remains by far the largest Arab market, and is one of the world's main trading nations in terms of goods and services.

The Kingdom provides ample scope for the export of high technology goods, especially those related to telecommunications, computer equipment and services, water and electricity supply and maintenance.

Saudi Arabia still depends on imports for most of its manufactured items, and many of its food stuffs. Capital goods make up the bulk of imports, though consumer products are not far behind.

Customs duties

All goods imported into the Kingdom require customs clearance which may only be obtained upon payment of the applicable customs duty. If an importer fails to settle the duty, the customs authorities are empowered to sell the goods to recover the due amount.

Basic consumer food stuffs such as sugar, rice, tea, unroasted coffee, barley, corn, livestock and meat (fresh or frozen) are exempt from duty. On most of the other items the duty ranges from 4% to 12%. Members of the Arab League who are signatories to the Agreement to Facilitate Trade and Exchange are granted special concessions. Similarly, imports from the Arab countries with which the Kingdom has bilateral trade agreements and Gulf Cooperation Council countries are also entitled to favorable rates of duty.

ACCOUNTING AND AUDITING

The profession

The accounting profession in the Kingdom is regulated by the Ministry of Commerce which is the authority responsible for issuing practicing licences to qualified individuals. There are presently around 400 licensed accountants in the Kingdom.

The professional accounting body, Saudi Organization for Certified Public Accountants (SOCPA) in the Ministry of Commerce is assuming a leading role in organizing and further developing the profession. SOCPA has been entrusted the task of developing professional standards and holding professional examinations for the practicing licence.

Standards and reporting

SOCPA has issued the following pronouncements:

- the Certified Public Accountants Code;
- Saudi Arabian Auditing Standards;
- Saudi Arabian Accounting Concepts and Objectives and the Standard of General Presentation and Disclosure;
- Saudi Arabian Accounting Standards.

The development of accounting and auditing standards is a continuous process. SOCPA therefore issues accounting and auditing pronouncements from time to time in an endeavour to set the Saudi Standards for all relevant topics and issues and to bring them up to date in accordance with the business requirements.

Companies are required to follow the International Financial Reporting Standards if guidance is not available on a particular issue in the Saudi Accounting Standards.

The Companies Law and the Department of Zakat & Income Tax requirements necessitate an annual audit for most types of companies. All companies registered in accordance with the Companies Law are required to file their audited financial statements with the Ministry of Commerce within six months of their financial year end. Additionally, companies with foreign participation are required to file their audited financial statements together with a special report with the Ministry of Industry and Electricity.

Accounting periods

A company may select any date as its accounting year end date. Companies registered in accordance with the Companies Law generally have their accounting year end date specified in the memorandum or articles of association.

Accounting records

All business entities operating in the Kingdom with a capital of SR 100,000 or more are required by the Commercial Book-Keeping Regulations to maintain at least the following accounting records in Arabic:

- original journal;
- inventory book;
- general ledger.

Additionally, all correspondence pertaining to the entries recorded in the books of accounts must be kept and maintained in a systematic manner to facilitate audit verification process.

The minimum period of retention for the accounting records and related correspondence is 10 years.

TAXATION

General

The tax system of Saudi Arabia is promulgated by the central government through royal decrees, ministerial decisions and circulars of the Department of Zakat and Income Tax (DZIT) of the Ministry of Finance and National Economy. The DZIT is exclusively responsible for the administration of tax and zakat matters. The Department has its head office in Riyadh and branches in the major cities of the Kingdom.

The two principal forms of taxes in Saudi Arabia are the zakat and the income tax. Zakat is assessed on Saudis where as income tax is only applicable to non-Saudis.

Zakat

Zakat is a religious tax, levied on Saudi nationals, wholly Saudi-owned companies and the Saudi shareholders' share of profits of companies with foreign participation, in accordance with Islamic law "SHARIA". For this purpose, GCC nationals and companies are treated as Saudis. Zakat is payable annually on the zakat payer's total capital resources and income, excluding amounts invested in fixed assets. The rate of zakat is 2.5%.

Income tax

A current income tax law was promulgated by Royal Decree no. M/1 on March 06, 2004 and became effective from July 30, 2004. With the exception of withholding tax provisions which are applicable from July 30, 2004, the new income tax law and its by-laws apply to financial years starting after the effective date of the law.

Under the new tax law, income tax is levied on the taxable income of:

- resident non-Saudi individuals in business;
- non-resident individuals or companies carrying business activities through a permanent place of business in the Kingdom such as agents, branches, construction sites etc;
- the non-Saudi partner/shareholder's share in a Saudi partnership/company.

For this purpose, all income or gains generated from business, or deemed to have arisen from business, within Saudi Arabia, are treated as taxable income. The source of income is deemed to be situated within Saudi Arabia if it is derived from:

- work, service or activity or any part thereof performed within Saudi Arabia;
- disposal of ownership interest in a Saudi company or partnership;
- rental of movable assets , sale or license to use industrial or intellectual property in the Kingdom;
- immovable property in the Kingdom, including gains on disposal of such property;
- management fees or director's fees paid by a resident company.

For income tax purposes, a contract to supply goods to the Kingdom is not considered a source of income derived from an activity in the Kingdom unless it includes related work which is performed in the Kingdom, such as installation, training etc. In such a case, only the income from related work is considered to be derived from an activity in the Kingdom and is, therefore, treated as taxable.

Income tax rates

A 20% income tax rate is applicable to the taxable income of non-Saudi individuals in business, companies registered in Saudi Arabia, and non-resident individuals and companies carrying business activities through a permanent place of business in the Kingdom.

A Natural Gas Investment Tax (NGIT) is applicable on taxable income derived from exploration, production, collection, treatment, transportation, processing and fractionation of natural gas, natural gas liquids and gas condensates. The NGIT rate for any taxable year is determined based on the internal rate of return on the cumulative annual cash flows of the taxpayer from the natural gas investment activities. Based on the NGIT rates table, the NGIT rate can range from a minimum of 30% for an internal rate of return of 8% to a maximum of 85% for internal rates of return of 20% and above.

A tax rate of 85% is applicable to the taxable income from oil or other hydrocarbon production activity in the Kingdom.

Withholding tax

Payments made to non-residents by a resident or a permanent establishment of a non resident, that are from a source in the Kingdom, are subject to withholding tax. Depending upon the nature of payment, the payer is required to withhold the tax at the following rates:

	Tax Rate %
Management fees	20
Royalties, payments to head office or related parties for services	15
Dividends, loan charges, insurance/reinsurance premiums, rental (lease), technical and consulting services, air tickets, air freight , shipping, and international telecommunication services	5
Other payments	Not to exceed 15

The person withholding the tax, irrespective of whether or not he is a taxpayer under the tax law, is required to register with the DZIT, and pay the tax so withheld within 10 days after the end of the month in which such payments are made. The payer is also required to issue a certificate to the payee stating the amount of payment and the tax withheld.

At the end of each tax year, the payer is required to submit the names, addresses and other details of the payees to the DZIT.

A delay penalty of 1% of the amount of unpaid withholding tax is applicable for each 30 days of delay from the due date of the tax till such time the tax is paid.

Other taxes

At present the following taxes are not imposed in the Kingdom:

- Personal tax on employee's remuneration.
- Value-added tax.
- Capital gains tax
- Estate and gift taxes.

Administration of tax

The procedures pertaining to administration of tax in the Kingdom are discussed briefly under the following headings:

- Basis of assessment.
- Filing of tax declarations.
- Payment of taxes.
- Statutory period of assessment / refund.
- Penalties.
- Appeals.

Basis of assessment

The net profit or loss, as adjusted for tax purposes, per the audited financial statements prepared in accordance with accounting principles generally accepted in the Kingdom, forms the basis of tax assessment for companies and other tax payers required to maintain books of accounts per the Commercial Book-keeping Regulations. An individual whose annual turnover is equal to or below SR 5 million may adopt either the cash or accrual basis of accounting for preparation of his financial statements. However, if his annual turnover for any taxable year exceeds this threshold, accrual basis of accounting must be applied in all subsequent years.

Filing of tax declarations

The following taxpayers are required to file a declaration with in 120 days of the end of their financial year with the DZIT along with payment for the amount of tax due:

- resident joint stock companies, limited liability companies, partnerships limited by shares, and investment funds;
- resident non-Saudi individuals in business;
- non-residents with a permanent place of business in the Kingdom.

Personal companies are required to file their tax declaration with in 60 days of the end of their financial year. Similarly, tax payers who cease their business activity are required to inform the DZIT, and file tax declaration with in 60 days of cessation of their business.

Tax payers whose taxable income exceeds SR 1 million are required to have their tax declarations certified for accuracy by certified public accountants licensed in the Kingdom.

All tax declarations and correspondence with the DZIT must be in the Arabic language.

Payment of taxes

If the tax liability, excluding the withholding tax, per the tax declaration of the preceding year amounts to SR 2 million or above, the tax payer is required to make advance payment of income tax to the DZIT in three equal installments on the last day of the 6th, 9th and 12th months of his current financial year whereby each installment is calculated as 25% of the preceding year's tax liability. No advance payments of tax are required if the preceding year's tax liability, excluding the withholding tax, is less than SR 2 million.

A credit for the advance tax paid, if any, is given against the total tax liability per the final tax declaration which must be submitted to the DZIT together with any tax due with in 120 days of the end of the financial year.

The DZIT may reduce the amount of advance tax payment if it is satisfied that the taxable income of the taxpayer for the current fiscal year is likely to be substantially less than the taxable income of the preceding year.

Statutory period for assessment / refund

The DZIT is allowed to issue or amend a tax assessment with in five years of the end of taxable year, or at any time with the written agreement of the taxpayer. In cases where tax declaration is not submitted or is found to be incomplete or incorrect with the intent of tax evasion, the DZIT is authorized to issue or amend an assessment with in ten years of the end of taxable year.

A taxpayer is allowed to claim refund for over payment of tax, at any time, within five years of the end of taxable year. In addition, the DZIT is required to compensate the taxpayer at the rate of 1% of the refund amount for each 30 days of delay, starting 30 days after the date of the claim till such time the amount is actually refunded to the taxpayer.

Penalties

A penalty of 1% of the gross income of the taxpayer, up to a maximum of SR 20,000, is payable if the tax declaration along with the payment for tax is not filed with the DZIT or, where applicable, the tax declaration submitted was not certified by a Certified Public Accountant.

In cases where the tax declaration together with the payment for unpaid tax is not filed within 120 days of the end of the taxpayer's financial year, a delay penalty of higher of the SR 20,000 mentioned above and an amount calculated based on the following is imposed:

Delay after the due date (no. of days)	Penalty (percentage of unpaid tax)
1 to 30 days	5%
31 to 90 days	10%
91 to 365 days	20%
Over 365 days	25%

The unpaid tax is the difference between the total amount due per the tax declaration and the amounts which have been paid on or before the due date of the declaration.

In addition to the above penalties, a 1% penalty of underpayment of tax for each 30 days of the delay shall be added in certain cases.

There are presently no penalties in force on late payment of zakat.

Appeals

The taxpayer may contest the tax assessment of any period through an appeal lodged with the Preliminary Tax Appeal Committee at the DZIT. The appeal must be filed within 60 days of receipt of the assessment and should outline the principal reasons for the objections. The appeal is not considered valid unless the undisputed element of the tax assessed is paid within the time period allowed for filing the appeal, except where the taxpayer has reached an agreement with the DZIT to pay the tax in installments.

The decision of the Preliminary Tax Appeal Committee may be contested by both the taxpayer and the DZIT through an appeal lodged with the Higher Appeal Committee. The appeal must be lodged within 60 days of receipt of the decision of the Preliminary Tax Appeal Committee.

The appeal is not considered valid unless the tax assessed by the Preliminary Tax Appeal Committee has been paid or a bank guarantee provided to cover the assessed amount.

The decision of the Higher Appeal Committee may be contested by both the taxpayer and the DZIT through an appeal lodged with the Board of Grievances within 60 days of receipt of the decision.

Dividends

Dividend distributions by companies in the Kingdom are subject to the provisions of withholding tax. As mentioned above, companies are required to withhold tax at the rate of 5% from the dividend and pay the net amount to the non-Saudi shareholders.

Supply contracts

Mere exportation of goods to the Kingdom, Saudi port, does not attract liability to income tax irrespective of whether the contract was signed inside or outside the Kingdom. The underlying principle is that the supply of goods does not constitute a source of income in the Kingdom.

Where the supply is connected with a service or work to be performed in the Kingdom (i.e supply, in-Kingdom transportation, installation) the income from the non-supply part of the contract, depending upon the DZIT interpretation, may become taxable. It is, therefore, advisable to sign a contract for supply independently of the contract which involves performance of work in the Kingdom.

Deduction of expenses

All normal business expenses are deductible from the income of taxpayer provided they are connected with the earning of that income and are supported by verifiable evidence. In general, the following types of expenses are disallowed:

- Payments or benefits, such as salaries, wages, bonuses etc., given to shareholders, partners or their relatives or payments for property or services to the extent that the amount is higher than the fair market value of such property or service;
- Insurance commission in excess of 3% of total premiums collected in the Kingdom;
- Entertainment expenses;
- Personal expenses of individuals;
- Income taxes paid in the Kingdom or abroad;
- Penalties and fines payable in the Kingdom, except where such fines result from contractual non-compliance;
- Illegal payments, such as bribes, even if paid abroad.

The specific rules in respect of deduction of certain expenses are as follows:

Depreciation

For tax purposes, the allowable depreciation expense is based on the depreciation rates and the fixed assets balances computed in accordance with the tax rules. The difference between depreciation expense charged in the taxpayer's financial statements and the one calculated using the tax rules is treated as an adjustment in arriving at the taxable income.

A list of annual depreciation rates allowed under the Kingdom's tax rules is as follows :

	%
Permanent buildings	5
Movable buildings	10
Geological surveys, drilling and exploration of natural resources	20
Plant, machinery, equipment, computer software and motor vehicles	25
All other tangible and intangible assets	10

The fixed assets balances, for the purposes of determining the annual depreciation expense in respect of each category, are computed as follows:

Fixed assets balance at the end of preceding tax year as per tax rules, net of depreciation expense of the preceding tax year	X
Add 50% of the cost of fixed assets additions in the current and preceding tax year	X
Deduct 50% of the amount of sale proceeds of fixed assets disposed off in the current and preceding tax year	<u>(X)</u>
Fixed assets balance for computing depreciation expense for tax purposes	<u>XX</u>

Where the fixed assets balance for any category becomes negative as a result of the deduction for 50% of sale proceeds of fixed assets disposed off in the current and preceding tax year, the fixed assets balance for that category is treated as zero and the excess amount is added to the taxpayer's taxable income.

Fixed assets repair and maintenance expenses

The amount allowed as fixed assets' repair and maintenance expense in each tax year is restricted to 4% of the balance of that category at the end of the tax year. The excess amount of repair and maintenance expense, if any, is added to the fixed assets balance of that category for the purpose of computing the depreciation expense for the current and future tax years.

Provisions

Except for the provision for doubtful debts of banks, no provisions are allowed as a deduction.

Bad and doubtful debts

Provisions for bad and doubtful debts are disallowed. However, bad debts written off are allowed as a deduction in the tax year in which the write off takes place provided certain conditions are met.

School fees

School fees paid by employers for their employees' children are allowed as a deductible expense provided they are paid to local licensed schools and the employees are entitled to this benefit per their employment contracts.

Employee termination benefits

Provisions for employees' termination benefits are not tax-deductible. However, actual payments made to employees are allowed.

Social Insurance

Payments to foreign social security schemes, foreign pensions and trust fund plans are not deductible.

Retirement fund contributions

Contributions to authorized retirement funds in the Kingdom by employers are allowed as a deduction up to 25% of each employee's salary. Employee's salary for this purpose excludes the employer's contribution to the retirement fund..

Head office expenses

Indirect general and administration costs, royalties, commissions, and financial costs charged by a head office located abroad to wholly owned subsidiaries in Saudi Arabia are not allowed.

Treatment of losses

The Saudi Arabian tax regulations allow indefinite carry forward of adjusted operational losses incurred after the expiry of tax holiday periods. However, the maximum amount of loss allowed in this way in any one tax year is restricted to 25% of that year's profit as reported in the tax return. The tax regulations however do not provide for carry back of tax losses.

Group taxation

The tax regulations in the Kingdom require each company within the group to file its own tax return with the DZIT. There are no provisions in the law permitting offset of losses of one group company against the profits of another.

Taxation of branches of foreign companies

Branches of foreign companies are taxed in the same manner as subsidiaries or associated companies. Income tax rates mentioned above also apply to branches.

CORPORATE INCOME TAX CALCULATION

Example: Corporate income tax calculation

A Saudi company owned 49% by foreign investor and 51% by a Saudi company.

Description	SR	SR
Net profit for the year per audited financial statements		30,000,000
ADD		
Depreciation differences resulting from DZIT approved method and rates	600,000	
Bad debts written off during the year not supported by documents providing evidence of attempts by the company to recover the debts	300,000	
Salaries paid to partners	1,000,000	
Social insurance and pension plans paid abroad	90,000	
Income taxes paid abroad	60,000	
Income taxes and zakat paid in Saudi Arabia	60,000	
Commissions paid to head office abroad	50,000	
Out of Kingdom head office indirect overhead expenses	25,000	
Out of Kingdom head office financial charges	75,000	
Entertainment expenses	40,000	
Provision for end of service benefits for the year	250,000	
Provision for bad and doubtful debts charged during the year	500,000	
Other provisions charged during the year	125,000	
Provision for Saving Plan	100,000	
		3,275,000
		33,275,000
Deduct		
Payments made during the year for end of service benefits and charged against end of service benefits provision added back to taxable income in previous years	250,000	
Payment made during the year and charged against a provision made in previous year provided such a provision was added back to taxable income in previous years	375,000	
Bad debts written off in previous years (but added back to taxable profits in previous years) now considered uncollectible, if supported by documents providing evidence of attempts by the company to recover the debts	500,000	
		(1,125,000)
Adjusted profit for Saudi income tax and zakat purposes		32,150,000
Non-Saudi partner's share (49% thereof)		15,753,500

Income tax @ 20%

SR 3,150,700