PRACTICE NOTE

Establishing a Branch Office or Presence in Saudi Arabia

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A Practice Note discussing how a foreign company can establish a business presence in the Kingdom of Saudi Arabia (Saudi Arabia). It outlines the key features of a representative office and a foreign direct branch, including how to establish a representative office (a branch limited to non-income generating activities) and a foreign direct branch carrying out full commercial income generating activities, how each operates and the applicable tax regime.

As an alternative to incorporating a new subsidiary, acquiring an existing entity, or entering a new market through a joint venture, a company can often enter a market through less expensive or formal methods, such as establishing a representative office (a branch limited to non-income generating activities) or a foreign direct branch (a branch carrying out income generating activities) in Saudi Arabia. The choice of business presence will usually depend on the type of activities that the foreign company wants to conduct, and the type of client(s) (as some dealings with government authorities will limit an investor to operate under a temporary license which itself is limited to performing a specific project for one specified client).

A representative office is often available when the activities to be performed are not deemed to generate income (for example, research into or observation of the jurisdiction as a new potential market). If, instead, the activities to be carried out are expected to generate income, the natural alternative to a subsidiary is often a foreign direct branch.

This note describes the options available for a foreign company wanting to establish a presence in Saudi Arabia. It describes the different types of business presence, focusing particularly on a representative office or foreign direct branch, how each operates and the applicable tax regime.

Establishing a Presence in Saudi Arabia

A foreign company has various options for establishing a business presence in Saudi Arabia. It could:

- Set up a representative office (see Representative Office).
- Set up a foreign direct branch (see Foreign Direct Branch).
- Incorporate a subsidiary company in Saudi Arabia (see Subsidiary).
- Appoint an agent, a distributor, or a franchisee (see Agent, Distributor, or Franchisee).
- Co-operate with a local partner and set up a joint venture (see Joint Venture).
- Establish a regional headquarters (RHQ) (for multinational corporations) (see Regional Headquarters).

To better understand the reasons a foreign company might opt to establish a representative office versus a foreign direct branch versus a subsidiary, see Alternatives to a Representative Office or Foreign Direct Branch.

The choice of structure is typically determined by:

- The type and scope of the activities the company will undertake.
- The applicable foreign investment regulations.
- The type of client(s) (as some dealings with government authorities will limit an investor to operate under a temporary license which itself is limited to performing a specific project for one specified client).

Foreign investors must comply with Saudi Arabia's foreign investment regime, which is primarily overseen by the Ministry of Investment of Saudi Arabia (MISA) (the organization that is essentially considered the foreign investment "gatekeeper").

The Saudi Business Center plays a central role in streamlining and automating the processes for registration, licensing, and ongoing regulatory compliance with the rules concerning Saudi Arabia's foreign investment regime.

In practice, the establishment of a formal presence (such as a foreign direct branch, a subsidiary, or a company through a joint venture agreement) is required if the foreign company intends to carry out commercial activities and generate income in Saudi Arabia, since income cannot be generated under a representative office (see What is a Representative Office?).

Foreign Direct Branch

A foreign company will often set up a foreign direct branch when the foreign direct branch itself is expected to generate income.

What is a Foreign Direct Branch?

A foreign direct branch is considered to be an extension of a foreign entity in Saudi Arabia and is not a separate legal entity. It operates under the legal personality of the parent company but, unlike a representative office, it can engage in the commercial, professional, or contracting activities that are permitted by its license. A foreign direct branch is not considered a standalone legal structure in comparison to a limited liability company (LLC) or a joint stock company (JSC), but it is still governed by the Companies Law and the MISA regulations and guidelines. The foreign direct branch is therefore fully subject to Saudi laws and regulations, including the foreign investment (see Foreign Investment Regulation) and commercial registration (see Requirements for Establishing a Foreign Direct Branch in Saudi Arabia) requirements.

The following elements concerning taxation may be relevant to a foreign direct branch operating in Saudi Arabia:

- **Corporate income tax.** Foreign direct branches are generally subject to corporate income tax in Saudi Arabia. However, consolidation of the financials of a foreign direct branch will have an impact on the requisite corporate income tax to be paid in Saudi Arabia.
- **Withholding tax (WHT).** WHT applies to a foreign direct branch when making payments (other than dividends) out of Saudi Arabia.
- **Value added tax (VAT).** VAT generally applies to all types of entities (including foreign direct branches), though there are minimum exceptions that apply to certain entities (such as holding companies).
- **Zakat.** Zakat is generally not levied on foreign-owned, foreign direct branches, as Zakat is a religious obligation for Saudi Arabian and GCC citizens and companies owned by them.
- **Other taxes/fees.** There are government costs and fees that apply when obtaining certain licenses and registrations. The amount of these costs and fees varies, depending on:
  - the nature of the activity (for example, whether it is a regulated activity);
  - the term of the activity;
  - the number of licenses/registrations being sought; and
  - the issuing authority (where the activity is a regulated activity).
- **Tax residency.** A foreign direct branch is not a permanent establishment (PE). A foreign direct branch is a form of an incorporated place of business, as opposed to a PE which is purely a tax concept for non-resident entities doing business in Saudi Arabia.

Specialist tax advice should be taken from a local licensed Saudi tax adviser in relation to all the above potential taxes and fees and in relation to Zakat.

For the differences between a representative office, a branch and a subsidiary, see Alternatives to a Representative Office or Foreign Direct Branch.

Requirements for Establishing a Foreign Direct Branch in Saudi Arabia

Foreign companies wishing to establish a foreign direct branch in Saudi Arabia must first register with MISA and also obtain a MISA Registration Certificate. The process to establish a foreign direct branch has been significantly streamlined in recent years, with most steps handled electronically via the MISA E-Services portal and the Saudi Business Center's E-Services platform. The key requirements include:

- The submission of an application to establish a foreign direct branch and obtain a MISA Registration Certificate from MISA (Article 236 of the Companies Law states that a foreign company must operate within Saudi Arabia in accordance with the Investment Law, whilst Article 7.2 of the Foreign Investment Law states that a foreign investor must register with MISA prior to engaging in any investment). The application must include:

  - the relevant corporate documents;
  - a resolution approving the establishment of the foreign direct branch; and
  - the details of the proposed business activities.
- The submission of proof that the foreign company wishing to establish a foreign direct branch in Saudi Arabia has been duly legally established in its own country of origin, which must be attested at the Saudi Embassy/Consulate in the foreign company's country of origin.
- The appointment of a general manager for the foreign direct branch.
- Obtaining a commercial registration (CR) from the Ministry of Commerce, following the issuance of the MISA Registration Certificate. Upon establishing a foreign direct branch, a CR must be obtained from the Ministry of Commerce after registering with MISA and obtaining the MISA registration certificate. When closing a foreign direct branch, the CR must be cancelled (see Closing a Foreign Direct Branch).
- Registering with the relevant authorities (such as the Zakat, Tax and Customs Authority (ZATCA), the General Organization for Social Insurance (GOSI), and any other regulatory bodies that are applicable).

Recent automation initiatives have reduced processing times and allowed much of the process to be completed electronically. Where all the paperwork provided is in order, this process usually takes about two to four weeks.

Business Activities of the Foreign Direct Branch and Requirements of Saudi Arabia

A foreign direct branch can only engage in the activities specified in both:

- The MISA Registration Certificate it has obtained from MISA.
- The parent company's constitutional documents.

Article 18 of the Commercial Registration Law Implementing Regulations provides that the carrying out of activities that are not included in the registration with MISA and the MISA Registration Certificate can result in the imposition of a fine of up to SAR10,000.

Certain regulated activities require the establishment of a specific type of entity and therefore cannot be conducted by a foreign direct branch. For example:

- Certain regulated activities require a specific percentage of Saudi ownership (including communication activities which require a minimum of 40% of Saudi ownership, and supportive communication activities which require a minimum of 30% of Saudi ownership), and these activities cannot be conducted by a foreign direct branch, as a foreign direct branch will not have the requisite level of Saudi ownership (unless exceptional approval for this has been provided by the competent regulator(s)).
- Certain capital market activities require the establishment of a closed JSC with variable minimum capital and ownership, depending on the regulated activity (for example, arrangement, advisory, and investment activities).
- Direct insurance activities require the establishment of a listed JSC.

Conversely, there are certain projects that are tendered by government authorities which are of a sensitive nature (for example, those concerning security) where it will be necessary for a foreign direct branch to be established which must then obtain a temporary MISA Registration Certificate permitting that branch to implement the project. Such a foreign direct branch will then be limited to only performing that project and cannot deal with third parties. This is due to the sensitive nature of the activities which are heavily regulated (for example, dealings with the Ministry of Interior).

A foreign direct branch must comply with Saudization requirements and the Saudi Arabia's broader policies on foreign investment, including reporting elements and compliance with local laws. For more detailed information, see Practice Note, Regulation of Foreign Investment in Saudi Arabia.

Foreign Investment Regulation

The Companies Law, the Investment Law, and their respective implementing regulations, govern the establishment of foreign direct branches. MISA assesses foreign ownership eligibility and may impose certain conditions or capital requirements depending on the activity and sector.

For more detailed information, see Practice Note, Regulation of Foreign Investment in Saudi Arabia.

Filing and Disclosure Requirements

A foreign direct branch must maintain a valid commercial registration and renew its MISA Registration Certificate as required. Mandatory annual filings include the provision of audited financial statements and tax returns, and ongoing compliance with the labor and immigration requirements. Some investors, for tax hygiene reasons, may wish to avoid setting up as a foreign direct branch to avoid the consolidation of their financials.

Executing Contracts

A foreign direct branch can enter into contracts in its own name, but such a contract must also stipulate that it is a foreign direct branch of the relevant foreign parent company.

Employment Matters

Foreign direct branches can directly employ both Saudi nationals and foreign national employees, subject to Saudization quotas and the work permit regulations. Saudization quotas require companies (including foreign direct branches) to employ a minimum percentage of Saudi nationals. The applicable percentage is based on the entity's sector and overall headcount, and the exact quota varies depending on the nature of the business activity and entity's size. The Saudization quotas generally prescribe that certain roles must be filled by Saudi nationals, and compliance with the quotas must be maintained to renew work permits and access certain government services (principally, those of the Ministry of Human Resources and Social Development). Where foreign nationals are employed, those employees will be sponsored by the foreign direct branch, but liabilities arising out of these employment agreements, and employment agreements with Saudi nationals, may be extended to the parent company.

Closing a Foreign Direct Branch

Closing a foreign direct branch involves:

- The cancellation of the MISA Registration Certificate granted by MISA.
- The deregistration of the foreign direct branch with the Ministry of Commerce. This process involves the cancellation and striking off of the foreign direct branch from the registration records of the Ministry of Commerce. This process typically takes between six to ten months, depending on the currentness or otherwise of the supporting documents provided.
- The notification of the closure to all relevant government authorities.

Final tax and labor clearances are also required before deregistration is completed.

The foreign company must also complete the following steps to close a foreign direct branch:

- Issue a board resolution approving the closure.
- Settle all outstanding liabilities, including to the tax authority (ZATCA) and the social insurance authority (GOSI).
- Cancel the CR (see Requirements for Establishing a Foreign Direct Branch in Saudi Arabia) and notify MISA and other relevant agencies of the closure.
- Publish a notice of the closure in a local newspaper (as required).

Taxation

A branch is subject to the standard tax regime applicable to foreign entities in Saudi Arabia, including corporate income tax, withholding tax on remittances, and VAT as applicable. Zakat (a mandatory charitable tax contribution that is levied on specific assets possessed by Muslims above a certain threshold (*nisab*) for a specified period (*haul*)) is not typically levied on foreign-owned, foreign direct branches.

Accounting Books and Records

Foreign direct branches must maintain accounting books and records in accordance with the Saudi regulations (that is, the Companies Law and the codes and regulations published by the Saudi Organization for Chartered and Professional Accountants (SOCPA)) and submit audited financial statements annually.

Representative Office

What is a Representative Office?

Technically a representative office is a branch limited to non-income generating activities.

Foreign companies tend to opt for a representative office when its activities in Saudi Arabia are deemed not to generate any income. For example, a foreign company with no establishment in Saudi Arabia could employ an individual (or several individuals) to carry out prospecting, marketing, and advertising activities.

A representative office in Saudi Arabia can support a company to gather data, conduct a review of the market in Saudi Arabia, and conduct other activities of a similar nature. This is a common approach for companies when setting up non-profitable chambers of commerce that aim to assist its country of origin's businesses in Saudi Arabia.

A representative office of a foreign entity in Saudi Arabia has no authority to exercise a commercial activity on behalf of such foreign entity (unlike a foreign direct branch, which can conduct the commercial activities permitted under its license (see Foreign Direct Branch)). However, like a foreign direct branch, a representative office is also not a recognised separate legal entity under Saudi Arabia law. Representative offices are only permitted to conduct the market research and promotional activities outlined above and cannot engage in direct income-generating business. As they have no separate legal identity, the parent company retains full liability for their activities. In practice a representative office is used for market research and promotional purposes, often testing the water for a more permanent commercial entity.

For the differences between a representative office, a branch and a subsidiary, see Alternatives to a Representative Office or Foreign Direct Branch.

Requirements for Establishing a Representative Office in Saudi Arabia

It is important to note that Saudi Arabia does not recognise a standalone legal structure known as a "representative office"(see What is a Foreign Direct Branch?). Instead, what is commonly referred to as a representative office is, in essence, a type of foreign direct branch. The distinction lies in the specific activity registered with MISA, which designates the branch as a representative office or a foreign direct branch carrying out income generating commercial activities.

This classification carries particular implications. Unlike regular foreign direct branches, a representative office is prohibited by MISA from engaging in commercial activities or executing contracts. Furthermore, it is not required to prepare or file financial statements. These limitations are what set it apart from other types of foreign direct branches operating in Saudi Arabia.

Otherwise, the requirements for representative offices concerning their establishment, foreign investment regulation, filing and disclosure obligations, employment matters, and closure procedures are very similar to those for foreign direct branches (see Foreign Direct Branch). The key differences are found in the sub-sections addressing executing contracts, taxation, and accounting books and records, due to the specific nature of the activity registered with MISA that designates the entity as a representative office, as explained above.

Foreign Investment Regulation

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia and Foreign Investment Regulation.

For further information, see Practice Note, Regulation of Foreign Investment in Saudi Arabia.

Filing and Disclosure Requirements

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia and Filing and Disclosure Requirements.

Executing Contracts

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia.

Employment Matters

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia and Employment Matters.

Closing a Representative Office

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia and Closing a Foreign Direct Branch.

Taxation

The taxation elements to be considered are mostly linked with the jurisdiction in which the investor is coming from.

Accounting Books and Records

See Requirements for Establishing a Foreign Direct Branch in Saudi Arabia and Accounting Books and Records.

Alternatives to a Representative Office or Foreign Direct Branch

Foreign companies may consider the following other options for establishing a business presence in Saudi Arabia.

Subsidiary

A foreign investor may choose to incorporate a subsidiary company in Saudi Arabia. The main types of company in Saudi Arabia that have limited liability for its share or equity holders are:

- An LLC.
- A simplified joint stock company (SJSC).
- A JSC.

A subsidiary is a separate legal entity, with limited liability for its shareholders (which is limited to the share capital/number of shares held in JSCs).

The incorporation process is similar to that for a foreign direct branch, but with the additional requirement of contributing share capital and appointing directors or managers. The subsidiary can conduct business in its own name and is subject to the same licensing, tax, and employment requirements as any Saudi company.

A subsidiary structure is often preferred where the foreign investor wishes to limit its liability and participate in the Saudi market as a domestic company. This is not only the most common preference for foreign investors, but also for local authorities in terms of their licensing requirements.

The LLC is the preferred type of company as a subsidiary for a foreign company (see also Practice Notes, Main Characteristics of a Joint-Stock Company (JSC) (Saudi Arabia) and Main Characteristics of a Simplified Joint-Stock Company (Saudi Arabia)).

For the differences between a representative office, a foreign direct branch and a subsidiary, see Alternatives to a Representative Office or Foreign Direct Branch.

Agent, Distributor, or Franchisee

A foreign company may consider appointing a Saudi agent, distributor, or franchisee to market its products or services in Saudi Arabia. In these arrangements, the foreign company is the "principal" and does not have a legal presence in Saudi Arabia. The local partner is responsible for complying with Saudi laws and assumes the primary legal and commercial risks. The commercial agreements differ, depending on the nature of the relationship and the commercial terms to which both the principal and agent/ distributor/franchisee agree.

Under Saudi Arabia law, special rules apply to agents, distributors, and franchisees, which are outside the scope of this Practice Note. Specific regulations also apply to commercial agency and franchise relationships, and registration with the Ministry of Commerce may be required.

For more information on these rules see:

- Practice Note, Key Agency Considerations: Overview (Saudi Arabia).
- Practice Note, Key Distribution Considerations: Overview (Saudi Arabia).
- Practice Note, Key Franchising Considerations: Overview (Saudi Arabia).

Joint Venture

Foreign companies may also consider co-operating with a local partner and set up a joint venture. However, in Saudi Arabia, the term "joint venture" does not refer to a specific regulated corporate structure as it does in certain other jurisdictions. Instead, it typically signifies two or more shareholders forming a standalone corporate entity (usually an LLC, SJSC, or JSC: see Subsidiary). The shareholders enter into a joint venture agreement internally, setting out the terms and their rights and obligations. This agreement is private and governs shareholder relations but is separate from the joint venture entity's constitutional documents (such as the articles of association or byelaws). A joint venture is therefore simply an agreement between multiple parties resulting in the formation of a corporate vehicle (LLC, SJSC, or JSC).

Where a foreign investor is part of a joint venture company, that joint venture company must comply with the Saudi investment and licensing requirements, and must register with the MISA, given the foreign capitalization element (irrespective of the amount contributed by the foreign investor).

Joint ventures are outside the scope of this Practice Note.

Regional Headquarters

Saudi Arabia encourages multinational corporations to establish regional headquarters (RHQs) as specialized entities to oversee and coordinate regional subsidiaries and branches.

What is an RHQ?

An RHQ is a non-commercial entity established by a multinational company to manage and coordinate its subsidiaries and branches within the MENA region from Saudi Arabia. RHQs facilitate management, strategic decision-making, coordination, and support services.

Additionally, RHQs must be separate legal entities (either as independent companies or foreign direct branches) which do not themselves directly engage in revenue-generating commercial operations.

Requirements and Regulatory Framework for RHQs

The establishment of an RHQ requires the multinational company to obtain a special license from the MISA, which will be granted provided the following conditions are met:

- The RHQ manages operations in at least two countries other than:
  - Saudi Arabia; and
  - the country in which the headquarters of the multinational group is located.
- Mandatory RHQ activities (for example, regional strategy, coordination, and financial oversight activities) must commence within six months of registration as an RHQ with MISA and obtaining the MISA Registration Certificate, and at least three optional RHQ activities must commence within a year of registration as an RHQ with MISA and obtaining the MISA Registration Certificate.
- The RHQ undertakes strategic management, coordination, and planning activities.
- The RHQ does not engage directly in commercial activities generating revenue.

Employment Considerations for RHQs

RHQs must have at least 15 full-time employees within one year of their registration with MISA, including three senior-level executives with relevant experience.

Differences between a Representative Office, a Foreign Direct Branch, and a Subsidiary

While the liability of a foreign company as the shareholder of a Saudi Arabia subsidiary formed as an LLC, an SJSC, or a JSC is limited, the liability of such company for a Saudi Arabia representative office or foreign direct branch is unlimited. As the representative office and foreign direct branch have no separate legal personality, the foreign company is fully liable for all debts and obligations of its Saudi Arabia representative office and foreign direct branch.

Setting up and maintaining a representative office or a foreign direct branch is less expensive and requires fewer filing requirements than a subsidiary company (for a representative office, see Requirements for Establishing a Representative Office in Saudi Arabia and Filing and Disclosure Requirements, and for a foreign direct branch, see Filing and Disclosure Requirements).

The key differences between a foreign direct branch and a subsidiary in Saudi Arabia include:

- Legal liability: a foreign direct branch does not have separate legal personality and the foreign parent is fully liable for its debts and obligations. A subsidiary is a separate legal entity, and liability is generally limited to the amount invested.
- Regulatory treatment: both are subject to foreign investment licensing, but a subsidiary is regarded as a Saudi company for most regulatory and practical purposes.
- Taxation: both are subject to Saudi tax on profits, but a foreign direct branch may have certain limitations and reporting obligations that differ from those of a subsidiary.
- Ease of establishment: foreign direct branches are often easier and faster to set up, with fewer corporate formalities, but they are less commonly used (except in professional services, contracting, or where market access requires it).
- Financials: foreign direct branches are likely to submit consolidated financials. Subsidiaries are subject to local corporate obligations (such as maintaining separate financial records, preparing audited financial statements, and complying with local corporate governance requirements), and are also subject to each foreign national investor's tax requirements in their country of origin.
- Potential growth: it is difficult for a foreign direct branch to expand and grow, whereas a subsidiary can incorporate new companies and enter into joint ventures as needed, subject to satisfying the locally applicable requirements.