

COMMENT

ESTABLISHING AN ENTERPRISE IN SAUDI ARABIA: A FOCUS ON A JOINT LIMITED LIABILITY PARTNERSHIP, CONTRACT NEGOTIATING, LABOR LAWS, AND INCOME TAX CONSEQUENCES FOR NON-SAUDIS*

I. INTRODUCTION

The motivation behind this work is to provide a practical legal guide for the foreign businessman (or his attorney) who is seriously considering establishing a non-petroleum sector business in Saudi Arabia. In response to the increasing political, industrial, and commercial ties that enmeshed Saudi Arabia and the West during the 1970's, a need for authoritative legal analysis grew. This need was especially clear from the fact that a majority of foreign businessmen involved had never before dealt with the Saudis. In particular, projects that involved the presence of the foreign business or businessman in the Kingdom, whether temporary or permanent, have sometimes been met by delays, obstacles, or even premature termination due to ignorance of the law. Unfortunately, there is still a dearth, if not a total lack, of appropriate, thorough, and current legal references, as far as the foreign businessman is concerned.

Before beginning, it is important to briefly look at both the Saudi legal system and the uses of Arabic in business dealings. First, the Saudi legal system is not based on any legal code in the Western sense. Saudi law is primarily Sharia law, as interpreted by the Hanbali school of thought, which is noted for its strict constitutional adherence to the Qur'an and Sunnah. The other schools are the Maliki, which emphasizes strict adherence to the tradition of the Prophet, as revealed in the Sunnah; the Hanafi, which emphasizes reason, analogy, and equity in interpretation; and the Shafi'i, which attempts to reconcile the approach of the Maliki and Hanafi schools.¹ All matters not covered

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1. Hoyt, *Overview of Legal Aspects*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 2, 2-4 (W. Wickersham & B. Fishburne III eds. 1977). See also W. BALLANTYNE, *The Role of the Sharia in the Arabian Gulf States*, in LEGAL DEVELOPMENT IN ARABIA 109, 111-13 (1980) and E. KAY, LEGAL ASPECTS OF DOING BUSINESS IN SAUDI ARABIA 6-20 (1979).

totally or directly by Sharia law, such as most commercial dealings, are supplemented by regulation by published Royal Decrees issued by the Council of Ministers and the various ministries.

Second, Arabic is the official language of Saudi Arabia, and all official decrees and proceedings and most documentation are in Arabic. In all areas where documents must be negotiated and agreed upon, it is crucial to focus on language simplicity and flexibility in order to obtain a workable and understandable Arabic translation. Furthermore, both versions of such documents should be prepared and signed at the same time. The role and use of the language is equally important to the success of the managerial and daily operations of the enterprise.

This work first focuses on the formation of a joint limited partnership, شركة تومسية . The Saudi government has offered many incentives to persuade the prospective foreign investor to use this form of entity as the means to do business in the Kingdom. This encourages the use of Saudi, non-oil, private sector capital to be invested in Saudi Arabia (as opposed to abroad) in mutually benefitting, long-term economic development projects and ventures. It also encourages the influx of much needed foreign technological assistance that is necessary to both the success of a particular enterprise and the overall development objectives of the Kingdom's second (1975-1980) and third (1980-1985) five-year plans. In particular, the latter (budgeted at \$235,000,000,000) is geared toward the establishment and expansion of productive industries, both private and public, as opposed to the former (originally budgeted at \$135,000,000,000), which concentrated primarily on industrial infrastructure.²

The focus shifts to the role and limitations of contract negotiations with both the public and private sectors. Once a foreign partner has been able to legally establish a joint venture in Saudi Arabia, many, if not most, of the activities of the enterprise will depend, directly or indirectly, on a written contract. Certainly, it is in the best interests of both the foreign and Saudi parties to have a written contract. It is important to emphasize that the foreign party who demonstrates patience, as well as determination and understanding of the Saudi people and society will, in general, be rewarded for his efforts.

It is also noteworthy that the Saudi government will not tolerate graft in the procurement of government contracts. This has been amply demonstrated in recent years. For example, in 1980, Hyundai, a

2. Mishlawi, *No Spending Loopholes in Saudi Plan*, THE MIDDLE EAST, June 1980, at 62.

major South Korean construction firm, was banned from doing business in Saudi Arabia for two years (probably losing over \$1,000,000,000 worth of business in the process); was fined \$90,000,000; and its director in Saudi Arabia was sentenced to thirty months imprisonment, allegedly for trying to bribe a top Ministry of Defense official.³ In addition, the imposed fine will double if Hyundai attempts to circumvent the ban, and other firms have been warned that they risk the same penalties if they attempt to do business with Hyundai in any form.⁴ The Saudi government also will not tolerate cost exaggeration in government contract bidding. Recently, several firms, from France, Austria, and Japan, that were accused of this were eliminated from bidding on water desalination projects.⁵

The Saudi labor laws are analyzed and although there are no unions, the use of labor is closely monitored and carefully controlled. The importance of understanding such controls for an indigenous business cannot be emphasized enough.

Finally, income tax consequences are highlighted. The focus is on the tax obligations of both a non-Saudi individual and an ongoing enterprise in the Kingdom. From this section the need for careful tax planning becomes very clear.

II. THE JOINT LIMITED PARTNERSHIP

The Saudi government has provided many obvious incentives for choosing a joint limited partnership as the form of doing business in the Kingdom. As about ninety percent of all ventures and enterprises have taken this form, it appears that this encouragement has been overwhelmingly successful.⁶ The Arabic is usually translated as "limited partnership" although it might be clearer to define it as a private shareholder's company.⁷ The partnership should have at least three partners, although only two partners are legally necessary, unless they are husband and wife, and cannot have more than fifty.⁸ Each partner is legally liable only to the extent of his share of ownership in the partnership and is not responsible, out of his own private property, for the

3. *Slap on the Wrist for Hyundai*, THE MIDDLE EAST, June 1980, at 62.

4. *Id.*

5. *Id.* See also Mishlawi, *supra* note 2. The Saudi government spent \$60,000,000,000 more on the second five-year plan than was budgeted, and, much of this it attributes to cost exaggeration in contract bidding with the government. This explains the harshness of the Saudi response.

6. Nazer, *Doing Business in Saudi Arabia*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 116, 119 (W. Wickersham & B. Fishburne III eds. 1977).

7. *Id.*

8. Companies Law of 1965, Royal Decree No. M/6 of 22/3/1385, AH, art. 157 (1965), reprinted in 1 BUSINESS LAWS OF SAUDI ARABIA 1-1 (N. Karam trans. 1978). See also Nazer, *supra* note 6.

debts and liabilities of the partnership beyond that.⁹ According to Saudi law and practice, the limited partnership is essentially a corporate body in the Western sense, possessing an independent personality, able to enter contracts within the scope of its operation, as well as the ability to sue and be sued.¹⁰ It should be noted here that a foreign company cannot own real property in the Kingdom, although it might have a limited right of ownership if the entity has been licensed under the Foreign Capital and Investment Law and if the use of the land is consistent with the license.¹¹ In addition to income taxation the limited partnership must divert at least ten percent of net profits per year into a reserve fund until the fund's total equals fifty percent of the original capital of the partnership.¹² However, the use of the fund is flexible and may be used, for example, to pay off debts of the partnership.¹³ The primary purpose of the fund seems to be insurance against bad faith venturer who have no intention of developing and nurturing a long-term enterprise.

Where the Saudi partner owns at least twenty-five percent of the initial capital, the Foreign Capital Investment Law provides extremely valuable advantages.¹⁴ First, the partnership is exempt from income and corporate taxation for five years, starting from the commencement of production for an industrial operation or the equivalent of production in a non-industrial operation. Second, the partnership is exempt from paying custom duties on machines, tools, equipment, and spare parts related to its operation. Third, the partnership is exempt from paying custom duties on primary raw and semi-processed materials, bags, containers, and the like. Fourth, the partnership is only charged nominal rent on all land needed for the operation or any necessary living accommodations. Fifth, the partnership will benefit from any proper government measure to protect national industries. So, if the

9. Mustafa, *Forms of Doing Business in Saudi Arabia*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 123, 126-27 (W. Wickersham & B. Fishburne III eds. 1977).

10. *Id.*

11. *Question and Answer Session*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 144, 145 (W. Wickersham & B. Fishburne III eds. 1977). This limited "property right" is comparable to an easement. See Royal Decree No. M/22 of 12/7/1390 AH, art. 3(c).

12. Companies Law of 1965, *supra* note 8, art. 176.

13. Burgoyne, *Specific Problems and Unique Aspects of Doing Business in Saudi Arabia*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 135, 139 (W. Wickersham & B. Fishburne III eds. 1977).

14. Foreign Capital Investment Code, Royal Decree No. 35 of 2/25/1964, *reprinted in* Mustafa, *Legal Aspects of Doing Business in Saudi Arabia*, in PRACTICING LAW INSTITUTE, THE MIDDLE EAST—A LEGAL UPDATE AND LEGAL ASPECTS OF THE ARAB BOYCOTT 13, 39 (1977).

appropriate government authority decrees that all non-national operations are limited or prohibited from importing certain foreign products, the partnership will be exempt. And finally, if the venture is a construction venture and the local partner owns sixty percent of the capital, the partnership is exempt from the ten percent profit retention fund.¹⁵

In addition, government focus on and encouragement of Saudi-controlled enterprises is clearly seen in the law governing procurement of government purchases and the execution of government projects and works, promulgated in May 1977. Article 1(d) stipulates:

Saudi individuals and companies licensed to operate in accordance with existing laws and regulations shall have priority in dealing with the Government. Next to them in priority are those entities consisting of Saudis and non-Saudis, where the Saudi share is fifty percent or more.¹⁶

This advantage of having the second highest priority in competing for government contracts can be, as a practical matter, the most important incentive, since the government is the biggest spender in the overall development process, as seen in the budgets of the three five-year plans, covering the period, 1970-1985.

After considering the above incentives, it becomes clear that the choice of Saudi partner(s) is very critical, beyond the normal concerns of entering a business partnership. It is beyond the scope of this work (perhaps any work) to explain to the foreign businessman or legal counsel how, when, and where to find a quality partner. However, certain aspects of the reality of Saudi society should be noted. First, it is crucial that the Saudi partner(s) be chosen for their family or bloodline connections with people working for or running the various ministries. In fact, the upper level officials of these ministries are overwhelmingly family connected.¹⁷ Thus, the closer the relationship, the better the chance of overall success for the enterprise. For example, if such an official feels that he has a stake in the outcome of the enterprise, the enterprise will be able to take advantage of his official privileges in the procurement of daily equipment and supply needs. In addition, it is important that Saudis, as a rule, tend to exclude themselves from a menial role in the enterprise and will never, in reality or in the abstract, accept a role subservient to that of a foreigner.

Once the ideal Saudi partner or partners have been found, all of

15. Foreign Capital Investment Code, Royal Decree No. 35 of 2/25/1964, art. 8. See also Mustafa, *supra* note 14, at 19-20, 29.

16. Royal Decree No. M/14 of 7/4/1397 AH (1977) reprinted in Mustafa, *supra* note 14, at 20-23.

17. *Saudis Start Restyling Administration*, WALL ST. J., Aug. 20, 1980, at 23, col. 2.

the partners must translate their good-faith intentions into very specific Articles of Association in order to be recognized as a limited partnership under The Companies Law of 1965 (hereinafter referred to as Companies Regulations). These Articles form the substructure of the operation and their embodiment should thus be considered critical to the success of the operation. If the Articles are too vague as to the responsibilities and duties of both the foreign and native partners, there is a distinct probability of future hostility and conflict. Since this will cost both time and money and will most likely be decided by a Saudi court the real result will be irreparable harm to the venture and the investment. At the same time, detailed provisions intended to cover remote and unlikely occurrences, as Western attorneys tend to include, should not be included.¹⁸ This standard form approach essentially is the result of development of rules suited to Western industrial and commercial needs and is usually unacceptable and/or impractical to the needs of business in the Middle East.¹⁹ Saudis attach a great deal of weight to confidence and trust in all relationships, whether business or private, and will hold a person to his word. Thus, insistence on complicated clauses to protect against remote possibilities can unintentionally be interpreted as evidence of mistrust, or even bad faith. At the least, it will have a damaging effect on further negotiations on the Articles of Association. This focus on simplicity becomes more crucial when attempting to translate the Articles into Arabic. As stated earlier, the Arabic text is the only legally recognized one. The Arabic version must thus correspond to the English as exactly as possible, a task sometimes difficult even with a simple text. A complicated provision, no matter how well intentioned, can easily be mistranslated. Even if all the partners understand, appreciate, and agree on a complicated provision, a translated clause might be misinterpreted by a third unrelated party if a dispute arises later. To reiterate, the warning to embody, agree to, and sign both the English (if appropriate) and Arabic versions of the Articles of Association at the same time is crucial. Finally, as discussed below, the Articles of Association must first be approved by the Ministry of Commerce. The Ministry can be expected to scrutinize the submitted Articles carefully and may require simplification or revision, consistent with the Companies Regulations. However, according to one experienced practitioner, the Ministry is "not very difficult to please."²⁰ Essentially, the partners are allowed great flexibility in determining the structures, powers, and duties of the management of the

18. Mustafa, *supra* note 9, at 129.

19. *Id.*

20. Nazer, *supra* note 6, at 119.

partnership and the methodology of transferring shares. However, concerning the latter, the partnership must maintain a special register with the partners' names, number of shares, and transactions affecting those shares, before any title transfer takes effect. Also, no transfer of shares to third parties is effective without prior notice to those partners who have a right to such notice.²¹

The Companies Regulations do list several areas that must be included in the Articles of Association. Among these are: (1) the partners' names, addresses, occupations, and nationalities; (2) the names of the managers of the partnership (these managers need not be partners); (3) the names of the board of controllers (where there is a foreign partner and more than twenty total partners, a board is usually established to handle management matters); (4) the amount of total capital to be invested by each partner; (5) all contributions in cash or kind; (6) a statement by all the partners that all shares have been allotted and paid in full; (7) a definition of the method of profit distribution to be used; (8) the dates of commencement and termination (if any) of the partnership; and (9) the form of notice to be served on the partners by the partnership.²²

Once the Articles of Association have been agreed to and signed by all of the partners, the foreign partner must apply to the Foreign Capital Investment Committee (part of the Ministry of Industry) for a license. This license is necessary before the foreign partner may invest his capital in the first place.²³ It also certifies that the partnership, if qualified, can receive all of the benefits listed above.²⁴ Along with the application, the foreign partner must submit a variety of documents, depending on whether the project is an industrial or an economic development project. For instance, for construction, specialized or technical service, and marine and land transportation service projects, copies of the following documents must accompany the application: (1) the signed Articles of Association; (2) eight copies of the application form in Arabic, including such relevant information as the object of the venture, the amount of invested capital, distribution of share capital and the proportion of capital contributed in kind; (3) documents, including an approved Arabic translation, showing that the individual presenting the application has the power of attorney, authorizing him to present and pursue the application on behalf of the

21. Companies Law of 1965, *supra* note 8, arts. 165-166. See also Mustafa, *supra* note 9, at 125.

22. Companies Law of 1965, *supra* note 8, art. 161. See also Mustafa, *supra* note 14, at 45.

23. Mustafa, *supra* note 14, at 45-46.

24. *Id.*

foreign partner; (4) proper documents authenticating the foreign partner's experience and activities both in and out of Saudi Arabia, including, at the least, the foreign partner's annual reports (in addition, the foreign partner should include documentation of his most important, completed project or projects); (5) a resolution by the foreign company's board of directors authorizing participation and investment in the project; (6) an authentic certificate of incorporation (and an approved Arabic translation) of the foreign company in its country of origin; (7) annual reports and audit budgets of the foreign partner for the past three years (or to the extent that that is practical); (8) a full description and valuation of all equipment, machinery, and facilities to be used in connection with the operation; (9) a document detailing the facilities and support that the foreign partner will provide the joint project; and (10) the foreign partner's official business address in his country of origin.²⁵

As mentioned above, the foreign partner must present documentation concerning the amount of capital the foreign partner will be contributing to the joint venture. Although the legal requirement is only S.R. 50,000, the Foreign Capital Investment Committee will focus on the type of activity contemplated in determining whether or not the foreign partner will be granted a license.²⁶ According to one experienced practitioner,

[I]f there is a foreign partner involved, the capital should be realistic because the Ministry of Industry expects the foreign partner to come to Saudi Arabia with a serious intention to create something. You cannot be taken seriously if all your capital is S.R. 50,000.²⁷

He then relates a personal experience.

I have letters from the Ministry of Industry in which . . . says, very frankly, that if your client raises the capital . . . S.R.500,000 to S.R.2,000,000, then we will give him a license. As soon as my client learned about this . . . in one day he increased his capital and the next day he got the license. So the Ministry of Industry really knows that the foreign partner comes with expertise and know-how and management and background and all these capabilities, but they want their contribution in the capital to be a realistic one.²⁸

25. *Id.* at 33-34.

26. *Id.* at 17.

27. Nazer, *supra* note 6, at 120. *See also* note 21, *supra*.

28. *Id.*

This is another clear example that the Saudis are interested in long-term development and in avoiding the pitfalls of a boom-town economy.

Once the license has been obtained from the Foreign Investment Committee, a copy of the issued ministerial decision and four copies of the signed Articles of Association must be submitted to the Ministry of Commerce (Company Registration Department).²⁹ The Ministry will then analyze the Articles to determine whether or not they are in accordance with the Companies Regulations. If the Ministry approves the Articles, it will write to a notary public in the town where the partnership will be headquartered, requesting that the Articles be notarized.³⁰ The foreign and Saudi partner(s), or their proper representatives, must appear in person before the notary.³¹ After this, the Companies Regulations require that the notarized Articles be published in *Um el-Qur'a* (Official Gazette) in Mecca before the partnership is recognized.³² This official organ is only published in Arabic and is the most authoritative source for government and official acts, even though there is an official, recognized translation of some of the Royal Decrees.³³ Unless otherwise specified, all published entries become effective the day after publication.³⁴

The final procedural step is to register the partnership in the Commercial Register and Companies Register. In order to satisfy the requirement, the following documents must accompany the application: (1) written application to the Ministry of Commerce requesting registration in the Commercial Register; (2) in the Companies Register; (3) the names of the members of the board of directors of the partnership (to the extent that it applies) and the photocopy of the managing director's passport or identity card; (4) four copies of the Official Gazette in which the Articles of Association were published; (5) four copies of the Articles of Association of the foreign company duly certified by the Saudi embassy in its country of origin; (6) documents showing that the partnership's capital has been deposited in one of the designated banks in Saudi Arabia; (7) a copy of the lease contract of the partnership's head office; (8) a letter from the partnership indicating the person authorized to sign the Commercial Register on its behalf; and (9) power of attorney authorization and delegation to a law firm to

29. Mustafa, *supra* note 14, at 36.

30. Nazer, *supra* note 6, at 120. A notary public in Saudi Arabia is an official of the government and not a private commission earner.

31. *Id.*

32. *Id.*

33. Mustafa, *supra* note 14, at 16.

34. *Id.*

conduct and to complete the incorporation informalities of the partnership.³⁵ Of course, most of these requirements have been met once the foreign partner has been granted a license. The apparent motivation for this "formality"³⁶ is to guarantee that all of the fairly complicated procedures have been met. The new partners have thirty days from the partnership's formation to apply for the publication of its Articles of Association and for registration in the Companies Register and Commercial Register.³⁷

Although the partnership is legally recognized, before beginning, the partnership's legal representative should meet with the Ministry of Finance, which handles taxation matters.³⁸ Even if the partnership has qualified for the five-year tax holiday, it is a good idea to prove to the Ministry that the partnership has at least twenty-five percent Saudi capital participation. This precautionary step could avoid unnecessary bureaucratic delays if the Ministry's records do not reflect that the partnership is entitled to the tax holiday to which it indeed is entitled.

Finally, it is important and revealing to note how the limited partnership may be legally dissolved. The law provides that the partnership may not be dissolved as a result of the withdrawal, incapacity, insolvency or bankruptcy of any of the partners, unless the Articles of Association have so provided. It may be dissolved if all of the shares have been transferred to one individual or partner. It may also be dissolved if all of the partners have agreed to dissolve if management reports that losses have equalled seventy-five percent of the partnership's original capital.³⁹

III. CONTRACT NEGOTIATIONS

Islam instructs the Muslim:

أوفوا بالعقود
يا أيها الذين آمنوا

"Oh, believers, honor your contracts."⁴⁰

35. *Id.* at 36-37.

36. Nazer, *supra* note 6, at 120.

37. Mustafa, *supra* note 14, at 125.

38. Nazer, *supra* note 6, at 121.

39. Companies Law of 1965, *supra* note 8, arts. 178-180. *See also* Mustafa, *supra* note 9, at 126.

40. Qur'an, Sura V:1. Note that Sura II:282 recommends to believers that they put their contracts in writing.

سأوريكم آيتي فلا تتعجلون
خلق الأ نسان من عجل

"Man was created from haste; I will make my revelations to you, but do not hasten me."⁴¹

When involved in contractual negotiations of any kind, with either a Saudi individual or government entity, it is important to keep in mind these instructions. It is crucial to focus on both a sound substructure and simplicity. According to some seasoned practitioners, both the lack of sound preparation and flexibility have brought woe to a good number of businessmen dealing with the Saudis.⁴² They emphasize that negotiations can last up to two months and that, although a pre-determined set of priorities is essential, an inflexible set of terms and conditions is unacceptable. In negotiating a contract in Saudi Arabia, it should be understood from the beginning that the contract, once signed, is not a panacea or an end in itself. Perhaps it would be easier for the Western practitioner to perceive the document as only a general embodiment of the intent and goals of the parties, as opposed to an agreement to inflexible and complicated terms designed to protect the offeror from all possibilities. The standardized contract approach, which has been used successfully elsewhere, will not work when negotiating with a private Saudi party. On the other hand, an attempt to obtain a contract with the Saudi government will, if successful, result in a standard contract form with little room for alteration.⁴³ The major reason for this approach stems from an extensive and sometimes sobering commercial experience with Europe, the United States, and the Far East.⁴⁴ The only real legal limitation on contractual terms is that they may not be offensive to Sharia law, as interpreted by the Hanbali school.

A. Arbitration Clauses and Settlement of Disputes

This area of international contractual law is not only the most crucial when negotiating with the Saudis, but also the most misunderstood. It is first important to focus on the role and limitations of an arbitration clause in a Saudi contract, both public and private. As a

41. Qur'an, Sura XXI:37.

42. See Hofker, *Essentials of Contracting*, in CURRENT LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST—SAUDI ARABIA, EGYPT, AND IRAN 49-50 (W. Wickersham & B. Fishburne III eds. 1977). See also W. BALLANTYNE, *supra* note 40, at 86.

43. Hofker, *supra* note 42, at 50.

44. *Id.*

rule, the Saudi government has been reluctant in the past to subject itself to international arbitration. Although it has not been involved in many such arbitrations, the callousness and condescension exhibited by early British arbitrators left a bad impression of international arbitration in the Middle East.⁴⁵ In fact, the attitude toward the Arabian Gulf countries in general had been that there was no rule of law at all!⁴⁶ Needless to say, the Saudi government had reason to feel that it could not and would not receive fair treatment in international commercial arbitration. On the other hand, in the 1958 arbitration between Aramco and Saudi Arabia, the Saudis felt that the decision was fair; and even though they lost, they carried out its terms.⁴⁷ Although traditional Sharia law does not prevent a Saudi government organization or agency from agreeing to international arbitration or from choosing non-Saudi law to govern the contract, in 1963 the Council of Ministers severely limited the ability of such entities to agree to the settlement of dispute clauses by prohibiting them to subject the entity to a foreign court's, or any non-Saudi judicial body's, jurisdiction.⁴⁸ In addition, and with only limited exceptions, an agency can neither accept arbitration nor foreign law as the governing law of the contract.⁴⁹ The term agency means any non-commercial government body that exercises a primarily government function, such as one of the various ministries.⁵⁰ It should be noted that an entity such as Petromin, which was formed by the Ministry of Petroleum and Minerals as a public organization to carry out commercial activities, is not such an agency.⁵¹ In fact, both Petromin and Aramco have in their most recent agreements included international arbitration clauses.⁵² Companies formed by various ministries to participate in industrialization contracts with foreign companies will also be allowed to agree to international arbitration in their contracts.⁵³ However, such government-owned entities will not agree to any term naming non-Saudi law as the governing law of the contract.⁵⁴

Any contract dispute involving a non-commercial entity will be resolved by the Saudi Arabian Grievance Board. The purpose of the

45. *Question and Answer Session*, *supra* note 11, at 149.

46. *Id.*

47. *Id.*

48. Burgoyne, *supra* note 13, at 140. *See also* Hoyt, *Saudi Arabia—A Legal Update—A U.S. Lawyer's Perspective* in PRACTICING LAW INSTITUTE, THE MIDDLE EAST—A LEGAL UPDATE AND LEGAL ASPECTS OF THE ARAB BOYCOTT 97, 107.

49. Burgoyne, *supra* note 13, at 140.

50. *Id.* *See also* Hoyt, *supra* note 48.

51. *Id.*

52. Hoyt, *supra* note 48.

53. *Id.*

54. *Id.*

Board is to administer and resolve certain decreed matters in accordance with Sharia law or, where Sharia law does not specifically cover the matter, in accordance with its principles.⁵⁵ The Board has four main members who are advised by numerous Sharia counselors, among others.⁵⁶ Usually, individual cases are handled by an appointed investigation committee which reports its findings to the President of the Board.⁵⁷ He, in turn, is advised by the remaining members before approving or disapproving the results of the investigation committee; the decision is final and cannot be appealed.⁵⁸ Although there is usually an obvious reluctance on the part of a foreign party to subject himself to this, at least one experienced practitioner has stated that there have been at least some settlements in favor of the foreign party, both in cases before the Grievance Board and before the Board for the Settlement of Commercial Disputes, which handles some private contractual disputes.⁵⁹ It is further pointed out that the problem has been exaggerated by foreign parties, who, in their ignorance of local law and misunderstanding of the Saudi judicial system, assume that they cannot obtain justice before a Saudi tribunal.⁶⁰ Of course, the problem is further frustrated by the language barrier and the dearth of qualified attorneys and legal references.⁶¹

When dealing with private contractual parties (as well as with such entities as Petromin), the only real limitation is that full consideration be given to the principles of Sharia law, as interpreted by the Hanbali school (in the 1958 arbitration mentioned above, it was accepted that Sharia law be supplemented by Hanbali interpretation where necessary).⁶² In fact, it is now required that where there is a provision for international arbitration, there must also be an express clause stating that any settlement be consistent with Sharia law.⁶³ Of course, when dealing with private parties, it is possible that the assertion that the Saudi tribunals are not capable or fit to resolve future disputes, may be interpreted as an insult or a sign of bad faith. In order to be successful in dealing with the Saudis (the same can be said of Arabs in general), it is absolutely crucial that there be a general and mutual feeling of both trust and trustworthiness. Thus, such a misinterpretation, whether justified or not, can thwart even the best planning and intentions. Of

55. *Id.*

56. *Id.* at 108.

57. *Id.* at 107.

58. *Id.* at 108-09.

59. *Question and Answer Session, supra* note 11, at 146.

60. *Id.* at 149.

61. *Id.*

62. W. BALLANTYNE, *supra* note 1, at 112.

63. *Id.*

course, there are some disputes which the Saudi courts are not capable of resolving, and thus, international arbitration will be in the best interest of both parties. It is apparent that the use of arbitration clauses is both increasing and being encouraged. In general, arbitration clauses are accepted and enforced by the Saudi courts.⁶⁴ However, recognition is not automatically extended to awards granted by international arbitration. So even if a party obtains an award and is able to reduce it to an actual judgment in a foreign court, if it is necessary to enforce it against assets in Saudi Arabia, it is very likely that a Saudi court will hear the case on its merits and apply Saudi law.⁶⁵

If indeed an arbitration clause is desired by both parties, it is again important to emphasize simplicity, both in terms and procedures. There is virtually nothing to gain by setting up a cumbersome procedure.⁶⁶ The best approach is to agree on one arbitrator and that his decision be final. If one does not expressly state in the contract that any arbitration award is not appealable, it is appealable.⁶⁷ Thus, it is vital that this arbitrator be the most objective and equitable third party available, as well as being international in character. There are three principal entities that have tribunals for the settlement of international industrial disputes—The International Chamber of Commerce (ICC), The United Nations Commission on International Trade (UNCTRAL), and The International Center for the Settlement of Investment Disputes (ICSID), which was established by the World Bank in 1966.⁶⁸ According to one experienced practitioner, ICC's arbitration clause has met with increasing, albeit not general, acceptance among the Arabian Gulf nations.⁶⁹ There are several possible reasons for this. First, a lot of countries in the Middle East have their own chambers, or the equivalent, and are comfortable with their role.⁷⁰ Second, the ICC has been acting as arbitrator for many years and has gained credibility and respect.⁷¹ Third, it essentially insures that the arbitrators they appoint

64. Hoyt, *supra* note 48, at 106.

65. *Id.*

66. W. BALLANTYNE, *The Law of the Middle East—The Legal Framework—How are Contract Disputes Settled—Arbitration—Agency of other Representation—Income Tax, With Special Reference to Kuwait, Saudi Arabia, Bahrain, Qatar, the United Arab Emirates and Oman*, in 41 LEGAL DEVELOPMENT IN ARABIA 50. A three-member arbitration board will almost always be cumbersome, because one member will realistically advocate the position of each side, leaving one member to cast the tie-breaking vote. Thus, it is better to provide for an arbitrator initially.

67. *Id.*

68. E. KAY, *supra* note 1, at 86-87.

69. W. BALLANTYNE, *The Gulf: Business Law*, in LEGAL DEVELOPMENT IN ARABIA 95, 104.

70. *Id.*

71. E. KAY, *supra* note 1, at 87.

fulfill their function. In fact, an arbitrator can be replaced if necessary.⁷² Finally, after a rule revision in 1975, there is a time limit of six months for handing down a decision, beginning when the terms are drawn up for the arbitrator.⁷³ The arbitration rules developed by UNCITRAL are also gaining advocates with governments throughout the world.⁷⁴ Although no specific machinery exists, the Secretary General of the Permanent Court of Arbitration at the Hague, or another agreed authority, may appoint an arbitrator.⁷⁵ The ICSID's arbitration mechanism applies to parties from states that have signed the 1966 ratifying agreement. Although over seventy countries have presently signed, Saudi Arabia has not.⁷⁶ The future of arbitration in the Middle East has some interesting potential. For instance, there has been some encouragement for Bahrain to set up an arbitration mechanism that is not only international in character, but also geared to the fertile, but sometimes treacherous, path of doing business in the Middle East.⁷⁷

Although of lesser importance than arbitration clauses, private parties may also agree to jurisdiction and choice of law clauses.⁷⁸ A jurisdiction clause vests jurisdiction in a court other than a court in the country in which the contract is to operate.⁷⁹ It is doubtful that any Saudi would agree to such a clause, and the Saudi courts will not generally accept ouster of their own jurisdiction.⁸⁰ A choice of law clause stipulates the system of law that the parties wish to govern the contract.⁸¹ The problem with these clauses is that, unlike some Middle East countries, such as Kuwait, Saudi Arabia has no conflict of laws code,⁸² so it is not possible to predict whether such a clause will be respected in a Saudi court. However, one experienced practitioner believes that the Saudi courts will possibly honor the clause if there is a close connection between the system of law chosen and the other incidents of the contract.⁸³ Another limitation is that some areas which are in the area of public policy or motivated by such policy cannot be subrogated to foreign law.⁸⁴ For instance, the Saudi labor laws stipulate that no laborer may work more than eight hours per day or forty-eight

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. W. BALLANTYNE, *supra* note 69, at 105.

78. W. BALLANTYNE, *supra* note 66, at 49.

79. *Id.*

80. W. BALLANTYNE, *supra* note 69, at 105.

81. W. BALLANTYNE, *supra* note 66, at 49.

82. W. BALLANTYNE, *supra* note 69, at 104.

83. W. BALLANTYNE, *supra* note 66, at 51.

84. *Id.*

hours per week.⁸⁵ If the system of law chosen to govern the contract is less strict than its Saudi counterpart, Saudi law prevails.

If no mechanism for settling disputes is stipulated in the contract, the case will be decided by the Board for the Settlement of Commercial Disputes.⁸⁶ The Board consists of three members—two judges qualified in Sharia law and one judge qualified in business and commercial law.⁸⁷ These proceedings are in Arabic and can often be lengthy.⁸⁸ One experienced practitioner urges parties to build into their contract a litigation clause that establishes a practical and effective procedure designed to obtain a quick result.⁸⁹ The Board decides each case on its merits and does not follow case precedent in its analysis.⁹⁰

B. Contract Types and Payment Mechanisms

There are several commercial contract types that have been used extensively, not only in Saudi Arabia, but also elsewhere in the Middle East. The first is the “design-only contract.”⁹¹ In this arrangement, one party designs or provides technical assistance, such as engineering services, but does little, if any, actual work in Saudi Arabia.⁹² The second is the “design, engineering and equipment supply contract.”⁹³ This type has not only all the aspects of the design-only contract, but also includes responsibility for providing and supervising the installation of equipment; however, responsibility does not extend to actual plant construction. The third type is the “turn-key contract.”⁹⁴ Here, responsibility extends not only to all the work necessary to the start-up of the operation, but also to the start-up itself, which must be to the satisfaction of the purchasing party.

Another area of contracting concern, especially with rampant international inflation, is price protection. In general, the more the contract calls for a presence in or responsibility in Saudi Arabia, the less desirable it is to have a fixed-fee payment mechanism, since there is a greater risk of cost overrun.⁹⁵ Of course, an additional factor is the amount of time specified in the contract to fulfill the agreed obligations

85. Labor and Worker's Regulations, Royal Decree No. M/21 of 6/19/1389 AH (1969), reprinted in 1 *BUSINESS LAWS OF SAUDI ARABIA* 9-1 (N. Karam trans. 1978).

86. Hoyt, *supra* note 48, at 106. See also Mustafa, *supra* note 9, at 131.

87. Hoyt, *supra* note 48, at 106.

88. *Id.*

89. Mustafa, *supra* note 9, at 131.

90. Hoyt, *supra* note 48, at 106.

91. Hofker, *supra* note 42, at 50.

92. *Id.* at 51.

93. *Id.*

94. *Id.*

95. *Id.*

of the contract. For instance, recently the United States Army Corps of Engineers, which was working on the initial phase of the King Khalid Military City Project, adopted, with Saudi approval, a "cost plus fixed fee" provision.⁹⁶ Such a provision often results in the lowest overall costs to both parties, although it requires a very technical financial audit procedure that is sometimes unavailable in the Kingdom. In this particular case, the project was to last up to eight years in a raw desert environment, and thus, was conducive to natural cost overrun; a fixed-fee provision would have resulted in a break-even situation at best.⁹⁷ Another approach, which was first used when heavily congested Saudi ports were causing monumental transportation delays in the 1970's, and more recently by a Belgian group awarded a hospital construction contract, is to have a fixed price revision provision based on any local inflationary increase (or decrease) in total labor and material costs; this allows both parties to benefit from any local fluctuation.⁹⁸ Although it is not presently possible to predict whether such limited Saudi approval for the above will mean general acceptance of price escalation mechanisms, for at least certain types of projects, the fixed-fee contract is detrimental to both parties, and an escalation clause should be allowed. It is also noteworthy that even with a reimbursable cost provision, it is important to have a provision allowing for at least some payment in advance.⁹⁹

Finally, it is important to note that when the contract is signed the contract period begins. Yet realistically, it might take up to six months to obtain the necessary financing, and this usually cannot be obtained without the signed contract. Thus, it is important to include such "lost time" in the time for performance provisions in order to avoid later legal and financial woes.¹⁰⁰

IV. LABOR

The basic labor law in Saudi Arabia is the Labor and Worker's Regulations, first promulgated in 1969,¹⁰¹ and updated since by decree and order, in order to cope with problems created by the massive influx of foreign labor in the 1970's. The scope of the problem is clearly seen when it is realized that Saudi Arabia only has an indigenous work force

96. Hoyt, *supra* note 48, at 104.

97. *Id.* at 105.

98. *Id.* at 104.

99. Hofker, *supra* note 42, at 53.

100. *Id.*

101. Labor and Worker's Regulations, *supra* note 85.

of about 1,500,000.¹⁰²

The labor law applies to all employees and workers irrespective of nationality. This interpretation has been litigated extensively and is clearly the official construction.¹⁰³ On the other hand, it does not apply to professionals, such as doctors and lawyers, who work on their own account.¹⁰⁴

The labor law provides a protective framework for both the employee and employer. The employee has a legal right to any employee benefit usually granted in normal business relationships.¹⁰⁵ Furthermore, any contract condition that purports to waive such a right is null and void under all circumstances.¹⁰⁶ Both employers and employees are legally obliged to become familiar with their rights and duties under the law.¹⁰⁷ Trained inspectors from the Ministry of Labor are charged with monitoring working conditions and have the right to enter work areas at any time to question and inspect.¹⁰⁸

In any week, no employee may work more than forty-eight hours or eight hours per day; however, during the holy month of Ramadan, the limits are reduced to thirty-six hours per week and six hours per day, exclusive of the time reserved for prayer and rest.¹⁰⁹ Overtime of at least one hundred and fifty percent must be paid for any excess of the daily or weekly limits (the same applies to weekly holidays, official feast days, or holidays which are normally paid holidays).¹¹⁰ Friday, which is a Muslim holy day, is a mandatory rest day with full pay.¹¹¹ There has been some litigation on this issue, usually involving incompatible straight-time and overtime scales. Where this does occur, the employers who have tried to avoid counting eight hours of Friday pay in computing overtime, in reference to the stated weekly limits, have never won.¹¹² Thus,

[t]he lesson for the employer is to make a clear distinction between basic straight-time weekly wages which must be paid for fifty-six hours, and overtime, which must be paid for actual worktime in excess of forty-eight hours or over eight

102. Taylor, *Changing Circumstances: Saudi Labor Law and Recent Developments*, 12 INT'L LAW. 661, 661 (1978).

103. *Id.* at 663.

104. *Id.*

105. Labor and Worker's Regulations, *supra* note 85, art. 6.

106. *Id.*

107. *Id.* art. 9.

108. *Id.* ch. 2.

109. *Id.* art. 147.

110. *Id.* art. 151.

111. *Id.* art. 169.

112. Taylor, *supra* note 102, at 665.

hours a day.¹¹³

In addition, no employee must work for more than five hours straight without a half-hour break and should not stay in his place of work for more than eleven hours at a time.¹¹⁴ However, twelve-hour day schedules have, in practice, been allowed in certain projects in remote areas.¹¹⁵ Meanwhile, ten-hour day schedules are common in the construction industry.¹¹⁶

The employer must protect his employees from the dangers and diseases resulting from the nature of their work and equipment.¹¹⁷ The employer is legally obligated to: (1) keep the enterprise in a good hygienic condition, clean and clear of all noxious odors from any source; (2) maintain ventilation of the company's work areas with sufficient scope for breathing according to standards set by the Ministry of Labor; (3) adopt the necessary precautions to protect employees against harm resulting from any gas, dust, smoke, or litter work by-product; (4) provide sufficient lighting during working hours; (5) make available at least one accessible water tap per fifteen employees; (6) secure sufficient toilet facilities; and (7) provide enough water for bathing purposes.¹¹⁸ Also, employees must be trained thoroughly in fire and accident prevention and, in case of an injury to an employee, a thorough investigation will be made as to whether the employer has met these obligations.¹¹⁹ Depending on the number of employees, an employer is legally obligated to provide free medical services to various, specific degrees. For under fifty employees, a well-stocked first aid cabinet and a trained technician in first aid must be provided.¹²⁰ For fifty to a hundred employees, a full-time, on-site nurse and a doctor who will run a company-owned clinic to dispense free medicine and treatment must be provided.¹²¹ For over a hundred employees, in-patient and specialist care, including surgery, must be provided, although contractual arrangements with local hospitals may be made to provide some of this treatment.¹²² A complete medical file must be kept for each employee, including a pre-employment physical and complete medical history.¹²³

113. *Id.*

114. Labor and Worker's Regulations, *supra* note 85, art. 148.

115. Taylor, *supra* note 102, at 667.

116. *Id.*

117. Labor and Worker's Regulations, *supra* note 85, art. 128.

118. *Id.* art. 129.

119. Taylor, *supra* note 102, at 667.

120. Labor and Worker's Regulations, *supra* note 85, art. 128.

121. *Id.*

122. *Id.*

123. *Id.* art. 136.

The labor law's definition of wages is all encompassing, including all premiums and high cost of living allowances.¹²⁴ Many employers have adopted Aramco's "balance-sheet" approach to compensate expatriate labor on the basis of what the foreigner could earn in a similar job in his native country plus a premium.¹²⁵ The approach seems to benefit both the employer, who can feel certain he is paying the market price for his labor (and thus generally for better quality labor) and the employee, who is earning a healthy premium (at times up to fifty percent).¹²⁶ Furthermore, since the foreign employee's salary is tied to his country's inflation rate, it can often help restrain the rampant inflation now in Saudi Arabia.¹²⁷ The reason for the need for foreign labor, in particular Yeminites, Pakistanis, and Egyptians, is due to the scarcity of Saudi labor.¹²⁸ Yet, as seen in the discussion up until now, Saudi Arabia desires maximum benefit for its citizenry, which accounts for only about one-third of the total work force.¹²⁹ On top of this, the Saudis fear that too much interrelation with non-Muslims will lead to disastrous results for their society. This attitude is reflected in the recent restrictions placed on visas granted to non-Muslim, non-Saudis seeking employment.¹³⁰ Saudis, by law, must constitute seventy-five percent of an employer's labor force, and total Saudi wages must be at least fifty-one percent of total wages, although the Ministry "may provisionally" relax these standards where Saudis with the necessary technical proficiency and academic qualifications are not available.¹³¹ Still, Saudis have a fundamental priority to all jobs and at all levels.¹³² Any employer with at least a hundred employees must train Saudis, in accordance with Ministry of Labor standards, equal to five percent of his total work force.¹³³ Often the Saudis will delay or restrict visas to expatriate laborers until satisfied that the employer is meeting his training obligations.¹³⁴

The focus shifts now to those circumstances under which an employer may legally terminate an employee. First, the labor law

124. *Id.* arts. 7.6, 124.2.

125. Taylor, *supra* note 102, at 666.

126. *Id.*

127. *Id.*

128. *Saudis Stop Granting Visas to Non-Moslem Aliens Seeking Work*, WALL ST. J., May 9, 1980, at 24, col. 3. Also see *Jobs Go Begging in Oil-Rich Mid East Lands*, WALL ST. J., Aug. 22, 1977, at 6, col. 2.

129. WALL ST. J., May 9, 1980, at 24, col. 3.

130. *Id.*

131. Labor and Worker's Regulations, *supra* note 85, art. 45.

132. *Id.* art. 48.

133. *Id.* art. 44.

134. Taylor, *supra* note 102, at 664.

distinguishes between definite and indefinite term employment contracts.¹³⁵ Although up to a ninety-day probationary period is permissible, where no such period is stipulated the employee is considered a regular from the first day of his employment; the employer will incur no liability, however, if an employee fails probation and is terminated.¹³⁶ If the employer-employee relationship continues after the expiration of a definite term contract, it becomes an indefinite term contract. In addition to the legal causes listed below, both parties have a legal right to receive notice in case of termination, with thirty days for monthly rate employees and fifteen days for daily wage laborers.¹³⁷ An employer may not cancel an employee contract without a bonus, compensation, or notice, unless the employee is given an opportunity to challenge the rescission and where it is established that: (1) the employee assaulted his employer or superior in the course of his work; (2) the employee failed to substantially perform his contractual obligations, to obey lawful orders, or to observe posted rules after being warned in writing; (3) the employee behaved improperly or committed an act "to the prejudice of morality and honesty;" (4) the employee intentionally, by act or omission, caused a material loss to the employer, if reported to the proper authorities within twenty-four hours of acquiring knowledge of it; (5) the employee resorted to fraud or forgery in order to obtain his position; (6) the employee failed, or was only hired for, a probationary period; (7) the employee, without lawful cause, has been absent for more than twenty days or more than ten consecutive days in any one year (for the former, written notice must be given after the tenth absence and the latter, after the fifth consecutive absence); (8) the employee discharged himself from proscribed medical treatment without the permission of the person in charge of that treatment (although he does not forfeit accident compensation under the Social Securities Regulations); and (9) the employee divulged any industrial or commercial secrets pertaining to his work.¹³⁸ On the other hand, if an employer fails to perform his contractual obligations, an employee may, without notice, leave his position as though there had been a rescission of the contract and without prejudicing his right to bonuses and damages due him.¹³⁹ When an employee terminates his employment, the employer is obliged to return him to the place of his recruitment.¹⁴⁰ It is noteworthy that the following are unlawful causes for discharging an employee: (1) if it is proven that the discharge was

135. Labor and Worker's Regulations, *supra* note 85, art. 70.

136. *Id.* art. 71.

137. *Id.* art. 73.

138. *Id.* art. 83.

139. *Id.* art. 84.

140. *Id.* art. 85.

solely due to the employee claiming his legal rights; (2) if the employee refuses to comply with an order transferring him from his original place of work and the order was without sufficient, lawful cause necessitated by the work involved, or the transfer would tend to cause grievous harm to the worker.¹⁴¹

There are two levels for the settlement of labor disputes—the Primary Commissions, located in the major provinces and cities, and The Supreme Commission. The former have final jurisdiction over disputes where the amount involved is S.R.3000 or less, stays of execution of employment termination, and disputes over fines or exemptions from fines, and have original jurisdiction with respect to all other disputes.¹⁴² The Supreme Commission hears all appeals from the Primary Commissions and its decision is final.¹⁴³ In reaching their decisions, these tribunals will apply Islamic religious law (Hanbali), local customs, legal precedents and principles of equity and usage.¹⁴⁴

Before concluding this discussion, it is important to note several other areas of interest. First, after a year of service, an employee is entitled to fifteen days of annual paid vacation and, after ten years, to twenty-one days.¹⁴⁵ Also, an employee gets three days off for marriage, birth of a child, and death of a spouse or relative.¹⁴⁶ Furthermore, where the illness is medically certified, sick pay is full pay for the first thirty days and seventy-five percent pay for the next sixty days, in any one year.¹⁴⁷ Second, throughout this discussion, the term *employee* has been used to refer to male employees. This is essentially because the overwhelming majority of the labor force is male, due primarily to Saudi cultural traditions. However, the law clearly envisions female participation by allowing for maternity leaves.¹⁴⁸ Finally, juveniles under thirteen may not be employed. Juveniles under eighteen may only be hired once an official birth certificate, issued by a competent doctor and approved by the Ministry of Health, a certificate of health for the work required, and the consent of the juvenile's guardian are presented; even then, he may only work for six hours a day.¹⁴⁹

141. *Id.* art. 75.

142. *Id.* arts. 172, 174.

143. *Id.* arts. 175-76.

144. *Id.* art. 185.

145. *Id.* art. 153.

146. Taylor, *supra* note 102, at 668.

147. Labor and Worker's Regulations, *supra* note 85, art. 158.

148. *Id.* art. 164. See also *Saudi Women Want to Work Too*, CHRISTIAN SCI. MONITOR, Dec. 17, 1980, at 23, col. 1.

149. Labor and Worker's Regulations, *supra* note 85, art. 163.

V. INCOME TAX CONSEQUENCES FOR NON-SAUDIS

The only purpose for the fairly extensive Saudi tax provisions is to tax the income generated by non-Saudis who work, do business in, or derive income from interests in Saudi Arabia. A tax is imposed on all income accruing from capital investments of non-Saudis, on the profits of non-Saudi corporations which carry on activities in the Kingdom and distributed profits to non-Saudis by corporations consisting of Saudi and non-Saudi members.¹⁵⁰ Furthermore, personal income includes all salaries, wages, fees, or rewards for any work or service rendered by a non-Saudi to any person or entity in any form and includes anything taken in lieu of the above.¹⁵¹ Since 1975, however, the wages of foreign workers in Saudi Arabia are no longer taxed.¹⁵² At the time this was done, in part to offset the effect of contrary tax provisions in the United States, although these were repealed in 1978.¹⁵³ The Saudis just could not afford more obstacles to importing the foreign labor so crucial to their development program. In general, income is defined as any profit, gain or compensation from any employment or activity, and it is immaterial whether the taxpayer is a resident of Saudi Arabia.¹⁵⁴

The tax rate on total personal income and on the net income or profits realized from capital investments in excess of S.R.6000 is: (1) five percent on that part of total income between the exemption limit and S.R.16,000; (2) ten percent on that part of income between S.R.16,000 and S.R.36,000; (3) twenty percent on that part of income between S.R.36,000 and S.R.66,000; and (4) thirty percent on that part of income in excess of S.R.66,000.¹⁵⁵ However, any income accruing to an individual from his financial investment in any company shall not be taxed if it has already been taxed under the Companies Tax, below.¹⁵⁶

Taxable profits of companies include: (1) net profits realized by every non-Saudi company doing business within only or both within and outside of Saudi Arabia; (2) total net profit dividends accruing to non-Saudi members of Saudi companies; and (3) total net profits

150. Income Tax Law of 1951, art. 1, *reprinted in* 1 BUSINESS LAWS OF SAUDI ARABIA (N. Karam trans. 1978).

151. Income Tax Regulations, Ministerial Order No. 340 of 1/7/1370 AH, art. 3 (1951), *reprinted in* 2 BUSINESS LAWS OF SAUDI ARABIA (N. Karam trans. 1981).

152. Royal Decree No. M/36 of 5/23/1975, *reprinted in* 1 BUSINESS LAWS OF SAUDI ARABIA 4-1 (N. Karam trans. 1978).

153. *Ah Relief: Americans in Saudi Arabia Get it Under the New Tax Laws*, WALL ST. J., Nov. 29, 1978, at 1, col. 5.

154. Income Tax Regulations, *supra* note 151, art. 2.

155. Income Tax Law, as amended by Royal Decree No. M/19 of 1/7/1390 AH, *supra* note 150, art. 6.

156. *Id.*

accruing to non-Saudi silent partners from commandite partnerships (as opposed to joint limited liability partnerships).¹⁵⁷ Companies that operate both inside and outside Saudi Arabia and formed under the laws of another country are taxed on all income derived from any local source within Saudi Arabia plus that part of total income generated through any combined activities within the Kingdom.¹⁵⁸ Such annual profits are taxed at a rate of: (1) twenty-five percent on profits less than S.R.100,000; (2) thirty-five percent on profits between S.R.100,000 and S.R.500,000; (3) forty percent on profits between S.R.500,000 and S.R.1,000,000; and (4) forty-five percent on those profits exceeding S.R.1,000,000.¹⁵⁹

However, the law provides both deductions and exemptions for companies, professionals, factory, and plant owners and traders (defined as a person engaged in commercial transactions as a profession in accordance with the Commercial Law).¹⁶⁰ The following deductions are allowed: (1) necessary, customary expenses related to the same business, such as rental of premises, and employee wages; (2) traveling expenses incurred for, or by reason of the business; (3) a reasonable sum for the depreciation of property used in the business, industry or agriculture, consistent with established custom and the nature of the operation; (4) established, unrecuperated business losses incurred during the assessed year; and (5) all dividends, accruing to the Government, including royalties accruing from concessionary companies.¹⁶¹ No personal expenses or debts are deductible unless they represent the price of goods bought, rental of the premises, or employee wages incurred during the assessed year; unrecuperated debts are taxable unless double taxation results.¹⁶² Among others, endowments and grants-in-aid paid to the Government, charitable bodies and institutions recognized by the Government are exempted from income taxation.¹⁶³

The methodology of tax collection and assessment is not burdensome, but is very important to understand, since there are serious, potential penalties for failure to comply. All taxes on the wages and salaries (over S.R.6000 per year) of employees subject to the Income Tax Law are to be deducted monthly by the employer, who is materially and morally liable for any failure or neglect to deduct or pay the

157. *Id.* art. 10.

158. Income Tax Regulations, *supra* note 151, art. 4.

159. Income Tax Law, as amended by Royal Decree No. M/19 of 1/7/1390 AH, *supra* note 150, art. 11.

160. Income Tax Regulations, *supra* note 151, arts. 10, 13.

161. *Id.* art. 13. The depreciation deduction reflects the amendment made by Ministerial Order No. 431 of 1/3/1373 AH (1953). *Id.*

162. *Id.*

163. Income Tax Law, *supra* note 150, art. 17.

tax.¹⁶⁴ If an employee is terminated, quits, or dies before the end of the taxable year, any amounts deducted during the year will be refunded to him or his heirs, since the tax is only due in respect to an entire year.¹⁶⁵ Companies registered under the Companies Regulations may pay such deductions all at one time, in respect to periods not exceeding three months or on or before the fifteenth day of the month following the period covering the deductions.¹⁶⁶ All such payments are to be paid to the administrative head of the Ministry of Finance and National Economy district in which the business is located.¹⁶⁷ When payment of employee deductions is more than five days late, a ten percent fine will be levied; if more than fifteen days late, the fine is twenty-five percent.¹⁶⁸

All salaried professionals, such as doctors, lawyers, and engineers, must submit a taxable income statement and pay the proper tax to the Department of Zakat and Income within fifteen days following their first year of residence in the Kingdom—delays in submitting either will result in the fines listed above. Thereafter, taxes must be paid within fifteen days following the months covering the due taxes.¹⁶⁹ If the professional is at the same time employed by any other individual, company, or government entity, all wages and deductions made by his employer are to be reported in his tax statement.¹⁷⁰

Every taxable company, bank, and trader must pay within two months and fifteen days following the end of the taxable year; delays will result in the fines listed above.¹⁷¹ The taxpayer must carefully maintain annual accounting records, since their accuracy must be proved; only then may a proper return be filed and the proper tax paid. If determined to be correct by an internationally recognized auditor, its conclusion will be accepted.¹⁷²

Any trader, businessman, professional, company or, in general, any person subject to taxation may be barred temporarily or permanently from: (1) carrying on his business; (2) leaving the country; and (3) transferring funds out of Saudi Arabia when taxes are not paid on the prescribed dates, incorrect tax information is submitted, or other purposeful acts or omissions are committed to evade or aid evasion of

164. Income Tax Regulations, *supra* note 151, art. 15.

165. *Id.*

166. Income Tax Law, *supra* note 150, art. 7.

167. *Id.* arts. 7, 18.

168. *Id.* art. 7. However, there are times when delays will not incur fines. See Tax Dept. Circular No. 12 of 1376 AH; Circular No. 15 of 1376 (liability for delay of fine tax); Circular No. 3 of 1379 (delay and evasion of tax fines); and Circular No. 5 of 1393.

169. Income Tax Regulations, as amended by art. 8 of Decree No. 17/2/28/576, *supra* note 151, art. 15(b). See also Income Tax Law, *supra* note 150, art. 8.

170. Income Tax Law, *supra* note 150, art. 9.

171. *Id.* art. 15. See also Income Tax Regulations, *supra* note 151, art. 16.

172. Income Tax Law, *supra* note 150, art. 16.

payment.¹⁷³ In addition, any government official who, by reason of his duty, jurisdiction, or work has anything to do with tax collection or assessment, divulges any secret obtained in the course of his duty, is subject to legal penalties and dismissal.¹⁷⁴ Such potentially harsh penalties are even more formidable, because the Ministry has almost unlimited authority to investigate and examine any dealings and documents of the business to determine the accuracy of the tax submitted.¹⁷⁵ It is noteworthy that the Ministry of Finance and National Economy strongly encourages companies doing business in the Kingdom to keep their accounting records in Saudi Arabia and in Arabic in order to avoid costly delays and inconvenience if a problem arises as to the properly chargeable tax.¹⁷⁶

If the Ministry investigates a taxpayer and assesses additional taxes, it must serve notice.¹⁷⁷ The taxpayer has thirty days from the date of the receipt of service to object to the assessment by a petition giving reasons for the objection.¹⁷⁸ Within thirty days of receiving the objection, The Preliminary Objections Committee, a three-member board from the Department of Zakat and Income, will address the merits of the case and determine by majority vote whether the proper figure should be the taxpayer's, the Ministry's, or a compromise. Notice of the decision must be received by both parties within fifteen days of its decision.¹⁷⁹ Either party may appeal this decision to another three-member board, appointed by the Minister of Finance and National Economy, within thirty days of receiving notice of the decision.¹⁸⁰ The Appeal of Objections Commission is not bound by the findings of The Preliminary Objections Commission and will make a final ruling by majority vote, although it is subject to the approval of the Minister; notice of the decision will be served on both parties within thirty days.¹⁸¹

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173. Income Tax Regulations, *supra* note 151, arts. 21, 31. See also Minister of Interior Order No. 949 of 15/2/1373 AH, barring foreigners from leaving the Kingdom without referring to the tax authorities for clearance.

174. Income Tax Regulations, *supra* note 151, art. 21.

175. *Id.* art. 18.

176. Ministry of Finance and National Economy Circular No. 4/1808 of 1/2/1393 AH, reprinted in 2 BUSINESS LAWS OF SAUDI ARABIA 2, 9-16 (N. Karam trans. 1981).

177. Income Tax Regulations, *supra* note 151, art. 22.

178. *Id.* art. 23, as amended by Ministerial Order No. 7/3314 of 18/9/1393.

179. *Id.* arts. 24-25, as amended by Order No. 7/3314.

180. *Id.* art. 28, as amended by Order No. 7/3314.

181. *Id.* arts. 29-30, as amended by Order No. 7/3314.