

Establishing a Branch Office by a Foreign Investor in Saudi Arabia

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Investors are conducting extensive due diligence to ensure that they structure their investment by establishing the type of entity which best suits their commercial objectives.

The establishment of a company in KSA is either by way of a limited liability company or, less frequently, a joint-stock company. This choice is generally driven by factors such as proposed shareholder numbers, management structure and the proposed activities of the company. Another potential factor is the possible need to include Saudi equity participation for activities such as for the importing, exporting, marketing, promotion and sale of products.

In addition to a company structure, in some cases a branch may be the optimum investment vehicle. The following is a brief overview of the two main types of available branch offices and the advantages and disadvantages of each. The two types of branches are:

- Permanent entity (a 'Permanent Branch'); and
- Technical & Scientific Services Offices ('TSSO').

This Article also comments on Temporary Commercial Registration which may be a possible structure in the context of government contracts.

In all cases, the selected establishment will require a foreign investment license from the Saudi Arabian General Investment Authority (SAGIA) and possibly other specific regulatory approvals.

Permanent Branch

A Permanent Branch is a conventional branch which would be considered as an extension of the parent office. The minimum start-up capital would commonly be approximately SAR 500,000. This would generally satisfy SAGIA's initial requirements.

The main advantages of a Permanent Branch are:

- depending on the circumstances, it may be the quickest to establish
- the formation process is generally similar to that of a limited liability company
- no new articles of association are needed
- it can have the full range of activities
- it can engage in projects in both the public and private sector (in accordance with approved objects)
- it may promote and solicit approved business throughout KSA

The main disadvantages of a Permanent Branch are:

- Saudi-owned entities, or entities involving substantial Saudi participation, are likely to be preferred for government contracts

- its activities are limited to the licensed objects approved by SAGIA
- there is a general expectation that substantive income producing activities will be undertaken
- it is not able to conduct promotion, marketing and trading activities (as a minimum 25% Saudi equity participation is required for these activities together with significantly greater capitalization)
- it cannot be formed solely to engage in representation or promotional activities
- the parent company cannot quarantine liability in KSA and may be exposed in its place of incorporation
- no other shareholders share the financial burden of capital requirements and setting up costs.

Technical Scientific Services Office (TSSO)

A TSSO may be used where there is a registered commercial agency distribution agreement between a foreign manufacturing entity and a registered Saudi distributor dealing with the local market.

A TSSO:

- can generally only be used in relation to complex products
- can assist the registered distributor in KSA with marketing and customer relations;
- must not market or sell products or generate any revenue
- does not require any capitalization
- requires the existence of a current distribution agreement registered with the Commercial Agencies Department of the Ministry of Commerce and Industry.

The main advantages of a TSSO are as follows:

- the formation process is simpler than a company and similar to that of a branch
- a TSSO may conduct market studies for the company's business activities and prepare reports arising from those studies to the parent entity
- there are no capital requirements

The main disadvantages of a TSSO are as follows:

- not all products are sufficiently complex to require a TSSO
- the applicant for a TSSO must be the actual manufacturer of the product, not a downstream supplier
- as there is no separate legal identity, the parent cannot quarantine liability in KSA and may be exposed in its place of incorporation
- as it does not have licensed objects like a branch, a TSSO cannot perform services outside of local technical support for the registered local distributor
- a TSSO is limited in terms of the number of employees with the number set by Saudi authorities;
- a TSSO must provide SAGIA with an annual report of its activities
- a TSSO must have a registered Saudi distributor.

It should be noted that the TSSO structure is not commonly used in KSA, mainly due to the disadvantages listed above and in particular because a TSSO

- must be established by the actual manufacturer
- cannot market or promote products and must only support the local distributor
- must provide technical and scientific services to the KSA distributor and consumers of complex products
- must conduct a market study for the company's business activity and prepare reports on such study for the headquarters
- must provide SAGIA with an annual report of its activity.

Temporary Commercial Registration (TCR)

Temporary Commercial Registration is not strictly a branch office and is only relevant to servicing a KSA government contract or semi-government company. The foreign investment license is generally issued

more quickly than for a conventional branch office (although a copy of the signed government contract will be required).

The main advantages of a TCR are that a TCR:

- can be obtained for consulting projects
- may sometimes be converted to a permanent commercial registration
- may be able to be converted from temporary status to a regular commercial registration at a later stage
- is generally easy to liquidate

The main disadvantages of a TCR are that a TCR:

- can only be issued to a foreign investor after it has been awarded a government contract
- may not be suitable for subcontractors on government projects
- is limited to the scope and duration of the contract (extensions to commercial registration may be applied for with the support of the government party)

cannot have the purpose of:

- promoting or marketing business
- monitoring or surveying market conditions
- providing other business opportunities

Conclusion

Whilst each particular situation requires assessment in the context of the relevant commercial objectives, in broad terms:

- a *Permanent Branch* may be the preferred option for a foreign investor that is keen to invest in KSA without being involved in the more complicated process and requirements for a limited liability company but at the same time wants to conduct normal business without the limitations imposed on a TSSO or TCR
- a *TSSO* may be the preferred option for a foreign investor that is interested only in providing technical support and to manage the relationship with their clients or potential clients on a limited scale
- a *TCR* may be the preferred option for a foreign investor which is a contractor that has a single project with a KSA governmental authority and does not want to satisfy the procedural requirements for setting up a formal branch.

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