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Key takeaways

- On January 6, the Saudi Ministry of Finance issued a new set of controls sharply limiting the ability of Saudi government agencies to do business with multinational companies that do not have regional headquarters in Saudi Arabia. The controls, which will enter effect on January 1, 2024, allow for only very narrow exemptions.

- The move is the latest evidence that the Kingdom is committed to implementing its regional headquarters policy, first announced with little warning or explanation in February 2021. Since then, the Saudi government has set up a Regional Headquarters (RHQ) Program within the Ministry of Investment (MISA) to attract companies to move their regional headquarters to the Kingdom, published more detailed guidance on the requirements and benefits of establishing an RHQ in the Kingdom, and introduced a licensing process.

- The RHQ Program has support of the most senior Saudi leaders, who see it as instrumental to the broader Vision 2030 goals to attract foreign investment, diversify the economy, and turn Riyadh into a regional business hub. Saudi leaders envision that the policy will bring senior corporate leaders closer to the Kingdom, increase their facetime with Saudi decision-makers, and ultimately lead to more investment in the Kingdom.

- For multinational companies doing business in the Kingdom, especially those that have significant business with the government, time is increasingly of the essence. If they have not yet done so, companies that wish to safeguard access to government procurement should move quickly to ensure they are ready to comply with the RHQ policy by 2024.

- This will require rigorous internal planning to address the various organizational, tax, operational, legal, and political aspects of any RHQ move. Companies should view the RHQ Program in the context of their long-term business goals in the Kingdom – this is not just about compliance, but rather strategic engagement with government decision-makers.

- With the RHQ requirement expected to enter effect less than a year from today, now is a good time to take stock of what we have learned since our March 2022 Analysis on the Saudi RHQ Program, what is still unclear, and what companies should be doing to prepare (see here for more on key considerations for companies).

Newly issued RHQ controls

The Ministry of Finance controls published in January impose sweeping restrictions on the ability of Saudi government ministries and other entities to contract with multinational companies that have regional headquarters that are not located in Saudi Arabia. MISA – in coordination with the Ministry of Finance and the General Authority for Foreign Trade – will be responsible for compiling and "periodically" updating a list of companies that do not have RHQs in the Kingdom. It is striking that the controls refer to a list of companies *without* RHQs as opposed to a list of companies *with* RHQs. This suggests that the Saudi government envisions most multinational companies (at least those that do business with the government) needing to establish RHQs in the Kingdom.

The controls outline a handful of narrow exceptions to the RHQ requirement. Government entities may contract with companies that do not have their regional headquarters in the Kingdom in the following circumstances:

- **If the contract is valued at less than 1 million Saudi Riyals (approximately $270,000).** This is a very low threshold that most government contracts with multinational companies will likely exceed. For comparison, when the Kingdom began to implement local content requirements in 2020, these requirements initially applied only to contracts valued at over SAR 50 million; that threshold was then incrementally lowered.

- **If the company without an RHQ submits a bid 25 percent lower than any qualifying bid by a company with an RHQ.** For comparison, the Kingdom currently offers only a 10 percent price preference for locally manufactured products, again underscoring the relative importance of the RHQ requirement for Saudi leadership.

- **If there is no qualified bidder with an RHQ.** For companies in competitive sectors, this will be a very difficult condition to satisfy. Even companies that offer highly specialized products or services may find it difficult to prove that only they meet the technical qualifications.

- **If there is an emergency that necessitates inviting companies without RHQs to bid.** The controls define an "emergency" as a situation that poses a threat to "public safety, public security or public health [that] is serious and unforeseeable."

To contract with a company that does not have an RHQ in the Kingdom, government entities will need to prepare a report making the case that one of the above exceptions applies. Requests for exceptions will be evaluated by a special committee chaired by the Ministry of Finance and with representatives from MISA, the Local Content and Government Procurement Authority, and the Government Expenditure and Projects Efficiency Authority. The inclusion of the latter two authorities is noteworthy; both entities have established reputations for aggressively enforcing local content and government procurement policies.

What we know

The February 2021 statement in which Saudi Arabia first announced its RHQ policy was sweeping in scope but included few details. The announcement itself was unusual in several respects. It was attributed to a "responsible source," rather than a specific government ministry or entity, and said that the government "intended" to stop contracting with companies that have RHQs outside the Kingdom, not that it definitively would. This created significant uncertainty and caused many companies to initially take a wait-and-see approach, reluctant to make decisions on the basis of limited or unclear information.

Since then, the overall picture has become much clearer, although some questions remain unanswered as we discuss further below. Over the past year, MISA has published guidance on the definition, criteria, and requirements of the RHQ in its Service Manual (a crucial step toward formalizing the RHQ Program), announced a standard package of benefits available to companies that establish an RHQ in the Kingdom, and launched an RHQ license application, among other steps.

Below we summarize the information on the RHQ Program that is publicly available (either in the MISA Service Manual, on the MISA website, or in other places) and other key considerations that have become clearer since our last Analysis.

Eligibility requirements

To be eligible for the RHQ Program, a company must have a presence (either through subsidiaries or branches) in **at least two different countries** other than Saudi Arabia and the country in which its headquarters is located. This is *not* a requirement for the number of countries that the RHQ must cover but rather for the minimum number of countries in which a company must operate in order to qualify for the RHQ Program. We believe this requirement is mainly meant to weed out companies that do not have significant international operations.

RHQ definition and criteria

An RHQ is defined as a "unit of a multinational company duly established under the laws of Saudi Arabia for the purpose of supporting, managing, and providing strategic direction to its branches, subsidiaries, and affiliates operating in the region." An RHQ must:

1. be established as a separate legal personality in the Kingdom of Saudi Arabia either as a subsidiary or as a registered branch office of a multinational company;
2. fulfill the RHQ license activities as described below; and
3. refrain from directly conducting commercial activities, defined as activities which generate revenue. This is consistent with MISA's conception of the RHQ as a "cost center."

RHQ licensing requirements

The MISA Service Manual and the RHQ License Application list a number of mandatory and optional licensing activities. The mandatory licensing activities fall under one of two categories: "strategic direction" (formulating regional strategy; coordinating strategic alignment; supporting mergers, acquisitions, and divestments; reviewing financial performance) or "management functions" (business planning; budgeting; business coordination; identification of new market opportunities; monitoring of the regional market, competitors, and operations; marketing planning for the region, and operational and financial reporting).

The even longer list of optional activities includes sales and marketing support; human resources and personnel management; financial management; accounting and legal functions; logistics and supply chain management; and research and development.

To maintain the license, the RHQ must:

- Commence **all of the mandatory licensing activities** within six months of the license being issued;
- Commence **at least three of the optional activities** within one year of the license being issued; and
- Employ at least **15 full-time personnel** within the first year; **at least three** of these employees must be in senior roles (defined as "Executive Director" or "Vice President" level or higher, although we understand that MISA is more concerned with whether these individuals are strategic or management decision-makers than with their exact titles).

Failure to abide by the above timeframes or other RHQ license requirements could, in theory, trigger cancellation of the RHQ license.

RHQ standard benefits package

MISA has published a standard list of benefits available to all qualifying companies that establish RHQs in the Kingdom, which includes:

- 10-year exemption from Saudization requirements;
- Spousal work-permits and extension of the dependent age limit to 25 years old;
- Waiver of professional accreditation requirements; and
- Visa limit exemption and accelerated visa issuance.

The decision to call these items "benefits" rather than "incentives" is intentional, reflecting that they are primarily meant to make it easier for companies to establish an RHQ, not to incentivize them to do so. For most companies, the most powerful incentive to establish an RHQ will continue to be the desire to preserve their access to Saudi government procurement.

Notably, the above benefits only apply to the RHQ itself, not to a company's broader business operations in the Kingdom. Of the listed benefits, the most significant (beyond continued access to government tendering) is likely the 10-year Saudization exemption, which should make it easier for many companies to move existing regional leadership and staff under the RHQ.

Other key considerations

- **The RHQ Program is a top priority across the government.** It was clear from the start that the RHQ policy was a priority for Saudi leadership. The original February 2021 policy announcement was accompanied by an organized promotional push on social media, with the ministers of investment, finance, and labor all issuing strong public statements in favor of the policy. More recently, the Kingdom has touted the names and number of companies that have agreed to establish RHQs in the Kingdom or obtained RHQ licenses. As with other top policy priorities, stakeholders across the government (beyond MISA and others closely involved in the RHQ Program) are all on the same page when it comes to stressing the importance of the RHQ.
- **MISA is responsible for day-to-day implementation.** While the RHQ policy is a priority across government, the RHQ Program itself sits under MISA. MISA has designated an RHQ Program Director who reports directly to the minister and draws on resources from

across the ministry to drive day-to-day implementation of the program. Other stakeholders, such as the Royal Commission for Riyadh City, which is leading a massive Vision 2030 push to turn Riyadh into a regional business hub, have a stake in the RHQ Program's success and may exert influence over the program, but MISA is the responsible authority and the main point of contact for companies on all RHQ issues.

- **Companies have flexibility in how to structure the RHQ.** Other than the requirements listed above, MISA has made relatively few stipulations about the structure of the RHQ, nor has it specified a minimum number of countries that must be covered by the RHQ. Companies can locate their RHQ anywhere in the Kingdom, including on the same premises as their existing operations, and receive the same standard RHQ Program benefits (although there may be future benefits to locating the RHQ inside a special economic zone). RHQ requirements do not specify an ownership structure or relationship between the RHQ and the entities reporting to it. And the RHQ need not report to a company's global corporate headquarters, provided that it reports to an entity based outside of the region with operations in at least two countries other than the country of incorporation and Saudi Arabia.

- **Filling out the RHQ application is not the hard part**. The RHQ license application, which is available on the MISA website, is relatively simple and straightforward. It asks companies to demonstrate that they meet RHQ Program eligibility requirements, to describe which geography the RHQ will cover (the Gulf Cooperation Council, the Middle East, the Middle East and North Africa, or "other"), to specify which optional activities the RHQ will cover, to provide a physical address for the RHQ, to designate an RHQ head, and to choose a duration of RHQ license (from one to five years), among other questions.

  Companies must also submit various supporting documents, including corporate financial statements for the most recent financial year, commercial registrations in at least two countries other than Saudi Arabia and the country of incorporation (to prove that they meet program eligibility criteria), a certified board resolution approving the establishment of a legal entity in the Kingdom, and an "RHQ Development Plan" that includes an estimate of the operating costs of the RHQ for the first three years of its operation.

  In our experience, completing the RHQ application form itself is the least difficult and time-consuming part of the process. What tends to take companies far more time is sorting out the various organizational, tax, legal, human resources, and operational implications of establishing an RHQ, weighing different RHQ options, and securing the necessary internal approvals to proceed.

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What is still unclear

- **Tax burden on the RHQ.** One key question that remains unanswered is whether companies risk any additional tax burden by establishing an RHQ. Current Saudi tax law defines an entity as a tax resident of Saudi Arabia if its "central management" is based in the Kingdom, even if the entity itself is based outside of the Kingdom. This has raised concern that companies establishing an RHQ could risk additional tax burden if entities based elsewhere in the region but reporting to the RHQ are treated as Saudi tax residents.

We understand that MISA hopes to issue clearer tax guidance soon, but discussions involving MISA, the Ministry of Finance, and the Zakat, Tax, and Customs Authority (ZATCA) are still ongoing. Part of the challenge relates to the differing mandates of these entities, with MISA focused on attracting investment while the Ministry of Finance and ZATCA seek to increase revenues. For now, in the absence of clear tax guidance, companies should, as part of their broader RHQ planning, engage with tax experts to understand their potential tax exposure under different interpretations of Saudi tax law.

- **Tax and other incentives.** Earlier draft versions of the RHQ benefits package mentioned potential tax and other incentives, but these references were subsequently removed. It is possible that tax or other incentives may be added at some point, but they are not currently part of the standard benefits package.

  Companies should also keep an eye on the development of the Saudi special economic zones (SEZ) program. The Kingdom is planning to create several special economic zones around the country, including the King Abdullah Financial District (KAFD) in Riyadh, which will reportedly focus on attracting RHQs. Late last year, the Kingdom formally opened its first special economic zone, the Special Integrated Logistics Zone, formerly called the Integrated Logistics Bonded Zone, at the King Khalid International Airport in Riyadh, with a benefits package that includes a 50-year exemption from corporate income and withholding tax, the waiver of customs duties and import restrictions, and no restrictions on capital repatriation or foreign ownership. Future SEZs, including KAFD, could be given authority to issue similar incentives, although it is premature to speculate exactly what kinds of incentives may be offered.

  Companies that decide to establish an RHQ now should not worry too much about missing out on potential future incentives, either within the SEZs or potentially outside of them. The Saudi government will likely seek to make future incentives retroactive to avoid punishing early movers.

- **Auditing requirements.** In the short term, we understand that MISA will conduct annual follow-ups to ensure that companies are complying with the terms of their RHQ licenses. This is consistent with current practice for other MISA licenses. However, in the longer term, it is possible that the Kingdom will introduce stricter auditing requirements for RHQ compliance, similar to those that already exist for local content. RHQ "levels." For now, all RHQs receive the same license and are eligible for the same standard set of benefits. However, we suspect that MISA will eventually introduce different RHQ "levels," which could take into account factors such as the size of the company, the geography covered by the RHQ, the number of employees of the RHQ, etc. These levels could in turn be tied to different incentives or differential treatment in procurement.

- **Working with semi-government entities and companies.** Taking local content requirements as a precedent, the Saudi government will likely focus first on government procurement, before extending RHQ requirements to procurement by SOEs and publicly owned companies. We believe this is more likely than the government seeking to apply the RHQ requirement to all government entities and SOEs from the start, although companies should still prepare for this possibility.

Key considerations for companies

- **Start now.** When we published our last Analysis, companies still had the luxury of taking a wait-and-see approach until RHQ requirements became clearer. That is no longer the case. If they have not started already, companies that do significant business with the Saudi government should immediately begin to develop a plan to comply with the RHQ requirement by January 1, 2024. While it is still possible that the enforcement of the RHQ requirement could be delayed, it is increasingly unlikely, especially given the recently issued procurement controls which specify an effective date of January 1, 2024 and outline mechanisms for enforcement.

- **Treat this as a platform for constructive engagement.** As they develop their RHQ strategies, companies should view the RHQ not simply as a compliance issue but as a platform for constructive engagement with the Saudi government. While companies just embarking on their RHQ plans now will likely have less leverage with the government than early movers, the RHQ issue may nevertheless present companies with an opportunity to start a dialogue with MISA about the broader business challenges they face in the Kingdom. While MISA will in most cases not be able to solve these issues on its own, it can help companies to raise these issues with other relevant government entities and will have added incentive to support companies planning to establish RHQs in the Kingdom. In this way, the RHQ issue may help companies to engage and strengthen their relationships with key stakeholders beyond MISA, including relevant sector regulators and policymakers.

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- **Consider the broader context in Saudi Arabia.** In their RHQ strategies, companies should give thought to the broader changes taking place in the Saudi investment landscape. Some of these changes, such as the development of special economic zones, represent significant potential opportunities for foreign investors (which we will discuss in more detail in an upcoming Analysis). In contrast, the government's ongoing focus on localization (in terms of both content and employment) and cost-efficiency will continue to present challenges. Companies should strive to develop an RHQ model that prepares them well to sustainably growth their business in the Kingdom and to navigate these longer-term trends in the investment landscape.

- **Preserve relationships in the wider region.** Finally, companies should carefully consider the implications of establishing an RHQ in the Kingdom for their reputations and relationships in the wider region, especially in the UAE, where many companies currently have their regional headquarters. While UAE leadership generally welcome "healthy competition" with the Kingdom, they will be sensitive to announcements which imply that companies are relocating their regional headquarters from the UAE or otherwise shifting investment away the country. Before any public RHQ announcement is made, companies should engage in honest and respectful conversations with key Emirati interlocutors to reassure them of their continued commitment to the UAE and sensitize them to any potential changes to their footprint in the UAE.

Suggested action plan for companies

While there is no one-size-fits-all approach, most companies will need to undertake, in some form or fashion, the following steps:

- **Information gathering:** We recommend that companies assemble an internal working group (ideally including commercial, legal, finance, HR, and government affairs representatives) to study the RHQ issue. This group will first need to gather critical information to inform the development of an RHQ strategy. This will likely include further information on the RHQ requirements and the implications of those requirements for the company. The working group should also gather information on the company's existing structure, business, and footprint in the region. This will help in preparing a business case for the establishment of an RHQ (including an estimate of the potential loss of business if the company can no longer access government procurement) and identifying parts of the business which may be especially exposed.

- **Strategy development:** The working group will then need to develop the core elements of an RHQ strategy, including a proposed RHQ structure, the list of roles that will fall under the RHQ (this is often an especially sensitive aspect), and a plan and timeline to stand up the RHQ. As part of this strategy, companies should also develop a communications plan to explain the RHQ decision to internal and external audiences – in Saudi Arabia, the wider region, and potentially globally. As the working group develops this strategy it should begin to socialize it with senior corporate decision-makers. This will likely require educating senior leaders on the background of the RHQ program and the broader business context in Saudi Arabia and the wider region.

- **Implementation:** Once companies have aligned internally on an RHQ strategy and obtained necessary internal approvals, they will need to implement this strategy. This will include completing the RHQ application and assembling the supporting materials, likely with support from legal counsel. Before submitting their RHQ application formally, we advise companies to first socialize it with relevant decision-makers at MISA to ensure that it meets all the requirements. This will help ensure a no-surprises approach. Once companies obtain an RHQ license the work begins to activate the RHQ. Companies will need to ensure that the RHQ is operational within six months of obtaining a license. This will entail, among other steps, establishing the RHQ as a separate legal entity, ensuring that the RHQ has a physical office (either a new office or space within an existing office), and migrating existing employees to the RHQ (which could include cancelling their current employment contracts and "re-hiring" them under the RHQ).

About ASG

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