Regional Headquarters in the Middle East – Changing the Landscape of Regional Management?

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The United Arab Emirates (UAE) in general and the Emirate of Dubai in particular have been the preferred location for setting-up regional headquarters in the Middle East and Africa (MEA) region. In February 2021, the Kingdom of Saudi Arabia announced that the country would require foreign investors to set-up regional headquarters to take part in public tenders. With an estimated public spend of USD 1 trillion in the upcoming years, foreign investors may need to review their current corporate structure against such new requirements. This briefing looks at the recent development and their implications for investors in the Middle East and Africa (MEA) region.

1. Introduction

The United Arab Emirates (UAE) and the Emirate of Dubai have traditionally served as the regional hub for European and North American companies. This is primarily due to the emirate's strategic location, excellent infrastructure and favourable tax environment.

Unlike other countries in the Middle East, the UAE currently does not levy any corporate income tax (CIT). While there are certain exceptions to this with regard to oil & gas activities, there are currently no concrete plans regarding the general roll-out of a CIT.

2. Mandatory Regional Headquarters in the Kingdom Saudi Arabia

The Kingdom of Saudi Arabia (KSA) has been traditionally served by the business hub Dubai. In the oil & gas sector, local content policies (LCP) incentivized the relocation of functions to KSA in the form of advanced localization scores. For example, under Saudi Aramco's In-Kingdom Value Total Add (IKTVA) program, suppliers are urged to build up operations in KSA, rather than supplying from abroad. Similar programs have been and will continue to be implemented by Saudi Basic Industries Corporation (SABIC) and Saudi Arabian Mining Company (MA'ADEN). The country's Local Content & Government Procurement Authority is expected to have broad oversight over local content measures. While these local content policies have proven to make a sector-specific impact until now, KSA in general and its economic centre Riyadh in particular have been left holding the short end of the stick in the race for regional headquarters (RHQ).

With Mohammad Bin Salman's (MBS) ambitious move to modernize the Kingdom and make it less dependent on oil, the country eagerly pushes for the execution of several key projects.

On the one hand, the country is in the process of setting-up a free zone almost as the size of Belgium in its North-western territory. Under the name NEOM, which is a combination of the Latin word "neo" (new) and the letter "M", which is an abbreviation of the Arabic word "Mostaqbal" (future), the free zone shall be developed as a centre of world trade. It is too early to say how fast NEOM will be developed and at what stage in the future investors will seriously consider it as a regional hub. Groundwork concerning infrastructure, in particular, air connectivity yet has to be carried out. Regardless of this, it is safe to say that NEOM will implement a legal and tax structure that is more favorable than KSA's current legal regime.

On the other hand, the government has taken the decision to make Riyadh an economic powerhouse in the Middle East and to double its current population to approximately 15 million people. The Royal Commission for Riyadh City (RCRC) has set the ambitious goal to attract 500 foreign companies to establish their RHQs in Riyadh in the next ten years.

Most recently, the government has indicated that it would require foreign bidders in public tenders to set-up RHQs in the Kingdom by 2024 in order to participate in governmental tenders. From the information available, the decision aims at "localizing" those businesses that are engaged with the Kingdom's government or any of its agencies, institutions, and funds. Ultimately, such a move will generate additional jobs and increase local spending. It remains unclear how RHQs are defined, in particular what functions would need to be carried out in the Kingdom.

3. Mitigating Taxation Burdens

In line with its Vision 2030, the Kingdom has created a new framework for so-called special economic zones.

According to the new plans to boost the development of Riyadh, King Abdullah Financial District Special Economic Zone (KAFD SEZ), once planned as a purely financial free zone, will now be converted into a commercial free zone. As such, KAFD SEZ is in the process of developing an investment promotion that is tailored to the needs of foreign investors. The planned investment promotion package includes:

- corporate income tax holidays (0%) for 50 years;
- waiver of Saudization requirements (min. 10 years);
- fast track commercial licensing applications;
- flexible choice of law; and
- preferential treatment in procurement.

In parallel, the government has set-up the Integrated Logistics Bonded Zone (ILBZ). In March 2021, the ILBZ issued its Companies, Employment and Implementing Regulations and Tax Rules.[1]

Among others, the ILBZ Rules & Tax Rules include:

- a 50-year Tax Holiday to include VAT suspension while under customs suspension;
- 100% foreign ownership; and

[1] General Authority of Civil Aviation (GACA), Integrated Logistics Bonded Zone IBLZ's Main Regulations <https://bit.ly/38LcUw0>.

- suspension of customs and import restriction.

4. Mitigating Workforce Nationalisation (Saudisation)

While the ILBZ Rules & Regulations do not contain any rules on waiving Saudisation requirements, the communication investment promotion for the KAFD SEZ includes a waiver of Saudisation requirements (min. 10 years). In line with this, Khalid Al-Falih, the Minister of Investment of Saudi Arabia, stated in an interview that Saudisation would be suspended for investors choosing to set-up or relocate their RHQS to the Kingdom.[2]

5. Conclusion

KSA is leveraging public procurement to attract foreign investment into the country. While the reasoning behind this move is plausible, central details of the new RHQ policy are yet to be clarified. In particular, the definition of RHQs has not been issued yet. However, it is expected that strategies to open a "nameplate" or a "secondary" RHQ will likely be insufficient, as Khalid Al-Falih pointed out.[3] Regardless of how rigorous the RHQ definition will ultimately be and to what extent it will be applied, the new course KSA takes is a clear indicator that the Kingdom will no longer tolerate the "Dubai model" of advisors flying in and out of the Kingdom.

Regardless, it should be noted that the Kingdom is *de facto* creating a level playing field with the UAE by offering CIT and potentially Saudisation holidays through its various investment promotions.

As far as KSA leverages on governmental contracts to push foreign investors into the Kingdom, the Kingdom has a strong lever compared to the UAE in general and the Emirate of Dubai in particular due to the announced investments. Keeping in mind the current local content requirement (LCR) related developments in the GCC (in particular in the oil & gas industry), it is expected that market fragmentation effects will be expedited. The lack of mutual recognition of LCR related investments among the GCC has already led to fragmentation effects, which will be expedited if KSA's RHQ policy will be as strict as announced.

2 Frank Kane, Saudization not to be forced on companies that move their HQs to the Kingdom: Investment Minister, Arab News, 22 February 2021 <https://arab.news/zezg6>.

3 "We would want to see the companies having a major headquarters office with executive staff; their C-suite being here; operations in other countries reporting to it; and support functions, whether it's training, product development, consolidation of regional operations, all taking place within their regional headquarters. So, a superficial nameplate saying 'this is the regional headquarters' will not fly[.]"

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