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## **MEMORANDUM**

### **Legal and Practical Aspects of Doing Business in Kuwait**

Articles 23 and 24 of the Kuwaiti Commercial Code state the basic premise for doing business in Kuwait. Article 23 provides that non-Kuwaitis cannot engage in commerce in Kuwait without having a Kuwaiti partner whose equity holding is at least 51 percent. Article 24 provides that a foreign company cannot establish a branch in Kuwait and it may not engage in commercial activities in Kuwait except through a Kuwaiti agent.

These two provisions pertain to public policy, and as such are mandatory. Non-compliance, therefore, among other things, renders the transaction null and void.

As an exception to Articles 23 and 24, a new law (Law No. 8/2001) has been enacted permitting foreign entities to establish Kuwaiti companies with up to a 100% foreign equity participation. Although a license under the new law can only be granted for certain types of business activities, the enactment of this legislation is a significant milestone in the legislative history of the country.

#### **Entering the Kuwaiti Market**

A foreign person or entity may enter the Kuwaiti market and do business in various ways. These are:

- *enter into a joint venture agreement;*
- *establish a corporate entity, that is, a limited liability company (referred to as a WLL), or a Kuwaiti shareholding company, closed (KSC Closed);*
- *appoint a local commercial agent;*
- *apply for a license under the foreign investment law for incorporating a company in Kuwait with or without a local partner.*

## **Joint Ventures**

The form most often used for doing business in Kuwait is the joint venture. The main reason for the popularity of this type of legal relationship is the ease with which it is formed.

Joint ventures are simple contracts that require no formal establishment procedures<sup>1</sup>. However, they can be the most confusing forms for doing business in Kuwait. Often foreign entities do not understand the nature of joint ventures under Kuwaiti Law.

The Kuwait Company Law refers to joint ventures as joint venture companies<sup>2</sup>. A joint venture company does not have a legal personality<sup>3</sup> and may not transact business in its own name. It may transact business with third parties only through one venturer, who would be personally liable for the transactions he enters into with third parties. The transacting venturer's liability to third parties is unlimited. The liability of a nontransacting venturer is limited to his share in the joint venture. Article 57 of the Kuwait Company Law states that a "joint venture" is a secret agreement between two parties, one of whom is the ostensible partner transacting business with third parties while the other partner is the secret partner. If the transacting venturer is a non-Kuwaiti, then the Kuwaiti venturer in the company must guarantee him in that transaction. If the joint venture were to deal with third parties in its own name, the effect would be to expose all of the joint venturers to unlimited joint and several liability whether or not they were personally involved in the transaction.

The limitation of joint ventures under Kuwaiti law is therefore obvious. Basically, a foreign entity would want to use its trade name and have control over transactions without risking unlimited liability.

In practice, foreign companies form joint ventures and enter into contracts with third parties in the name of the joint venture, which in reality transforms the joint venture into a different form of entity under Article 4 of the Kuwait Company Law, namely a de facto *sharikat tadamoun*. Under Kuwaiti law, this is a "company" that is similar to a U.S. general partnership.

## **WLLs and Closed Joint Stock Companies**

Another form of doing business in Kuwait is to form a legal entity with independent personality and limited liability. Under Kuwaiti law, there are two such company forms that are open to non-Kuwaitis. The first is the limited liability company (WLL).

A WLL is formed by a number of persons not exceeding 30 who shall be liable to the extent of their share in the capital of the company. The minimum number of partners in a WLL shall be two. Article 191 of the Commercial Companies Law provides that at least 51% of the WLL shareholding must be owned by a Kuwaiti.

A WLL is quite easily formed, the approximate time needed for its incorporation is three months. A WLL provides its shareholders with the limited liability shield.

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1. Kuwait Companies Law (KCL), Art. 57.  
 2. KCL, Art. 56.  
 3. KCL, Art. 59.

Typically, the shareholders of a WLL are referred to as “partners” (enjoying limited liability) and the shares owned by them in the capital of the WLL are referred to as “portions”. A WLL may not transact insurance business, banking or engage in investment activities<sup>4</sup>.

A Kuwaiti shareholding company, closed (KSC Closed) is the other type of company open to non-Kuwaiti entities. Articles 68 and 94 of the Kuwait Company Law provide for this type of company as an exceptional kind of a shareholding company. A shareholding company's shares may be publicly traded<sup>5</sup>. The general rule is that the shareholders of shareholding companies must be Kuwaiti nationals. As an exception, foreigners may own 49% of the share capital of a KSC Closed after obtaining the approval of the concerned authorities. The incorporation of a KSC Closed may take up to six months and requires compliance with extensive formalities and procedures prescribed by the Ministry of Commerce and Industry through out its corporate existence. A closed Kuwaiti joint stock company may, at a later stage, apply for listing its shares on the Kuwait Stock Exchange.

Basically, the effect of Articles 68 and 94 is to allow foreign companies, whenever there is need for capital or foreign expertise, to invest in a KSC Closed, provided the Kuwaiti shareholding is not less than 51 percent. This type of company provides the foreign entity with limited liability and the ability to function as an entity, hence allowing it to benefit from its goodwill and trade name.

### **Commercial Agents**

Commercial agencies are regulated by Law No. 36 of 1964 on the Regulation of Commercial Agencies, and the Kuwaiti Commercial Code, Chapter 5, Articles 260-296.

Article 1 of Law 36 provides that non-Kuwaitis may not act as commercial agents in Kuwait, and Article 10 provides that those who violate the rule are subject to three months' imprisonment and/or a fine.

The relationship between the Kuwaiti agent and the foreign principal must be direct. Article 2 of Law 36 provides that commercial agencies are not enforceable unless registered in the Commercial Register.

The Code's provisions set out the general rules governing commercial agencies and the types of commercial agencies.

The first type is a contracts agency<sup>6</sup>. In a contracts agency, the local agent, by contract, undertakes to promote the principal's business on a continuous basis in the territory and to enter into transactions in the name of the principal in return for a fee. The contract must be in writing and must include the territory covered, the

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4. KCL, Art. 187

5. KCL, Art. 63.

6. Kuwaiti Commercial Code (KCC), Art. 271.

agent's fee, the term, the product or service that is the subject of the agency, and any relevant trademarks<sup>7</sup>. The term of the contract must be at least five years if the agent is required to set up showrooms, workshops or warehouse facilities.

The second type of agency is a distributorship<sup>8</sup>, under which the local agent is the distributor of the principal's product in a defined territory in return for a percentage of the profit. Distributorships are governed by the same general rules as contracts agencies if the distributor is the sole distributor for the whole country. These rules provide protection to both types of agents.

The Explanatory Memorandum to the Code states that in view of the importance of commercial agencies to the Kuwaiti economy, and in view of the fact that the foreign party in such transactions is usually more powerful than the Kuwaiti, the legislature deems it necessary to protect the local agent. The following protective measures are provided:

- *Commercial agencies must be registered in order to be enforceable.*
- *Kuwaiti law is the governing law in matters pertaining to public policy.*
- *The principal may not terminate the agreement without proving breach of contract by agent; otherwise, the principal is liable for paying compensation to the agent<sup>9</sup>.*
- *The principal may not refuse to renew the agency agreement when it expires without paying the agent equitable compensation for non-renewal if the agent proves that he committed no breach and that his activities led to the successful promotion of the principal's products<sup>10</sup>.*
- *The agent may sue both the principal and any new agent that the former may appoint in Kuwait if the termination is proved to be the result of their concerted action<sup>11</sup>.*

The third type of commercial agency is the commission agency, which is provided for in Articles 287 through 296 of the Commercial Code. In this type of agency, the agent enters into contracts in his/its own name<sup>12</sup>. The principal's name may not be disclosed without his permission<sup>13</sup>, but this rule is difficult to adhere to in practice since most manufactured products bear the principal's name.

### **License under the Foreign Investment Law**

The Foreign Investment Law (No. 8/2001) proposes to regulate foreign investments in Kuwait. Under the new law it is intended to allow foreign investors to own up to 100% equity in Kuwaiti companies or ventures for special projects as

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7. KCC, Art. 274.

8. KCC, Art. 286.

9. KCC, Art. 281.

10. KCC, Art. 282.

11. KCC, Art. 284.

12. KCC, Art. 287.

13. KCC, Art. 292. This rule is of historical importance only and may be enforced only in the case of fungible goods for practical reasons.

determined by the Council of Ministers. It is expected that, this significant change proposed by the government will throw open the Kuwaiti markets to multinational

corporations giving them a free hand in doing business in Kuwait. Until recently, prior to the enactment of this law, foreign investors were subject to a ceiling of 49% (maximum) stipulated under the Law of Commerce No. 68 of 1980 and the Commercial Companies Law No. 15 of 1960. The law proposes to do away with such restrictions imposed upon foreign investors.

The Explanatory Memorandum to the law provides that “globalization of trade and privatization are international trends adopted by developed countries that have resulted in widening the role of the private sector while minimizing dependence upon the public sector”. The law seeks to encourage foreign investments and create new opportunities for local employment. The purpose of such legislation is to derive benefits from foreign technology and management and marketing experiences of foreign companies worldwide.

The Minister of Commerce is empowered to issue licenses to foreign investors, permitting up to 100% foreign equity participation in any economic project in Kuwait. Such projects shall be exempt from the provisions of Articles 23 and 24 of the Law of Commerce as well as from the provisions of Article 68 of the Commercial Companies Law, which require at least 51% local participation. Thus, the new law proposes to overcome what was regarded by many foreign companies as a pitfall in doing business in Kuwait.

Significant steps have recently been taken to implement this law. These steps include the setting up of the Kuwait Foreign Investment Bureau (KFIB) which facilitates filing of applications and the Foreign Capital Investment Committee, headed by the Minister of Commerce & Industry to process applications for grant of licenses. Ministerial Resolution No. 23 of 2003 issued by the Minister of Commerce & Industry contains the Executive Regulations. The Regulations provide the mechanism for the implementation of the law.

The Council of Ministers have under resolution No.1006/1 for the year 2003 issued a list of business activities for which a Foreign Investment License may be granted. These business activities include the following:

1. Industries except for enterprises related to Oil or Gas exploration or production.
2. Construction, operation and management of Infrastructure enterprises in the fields of water, power, drainage and communications.
3. Banks, Investment Corporations and Foreign Exchange Companies which the Central Bank of Kuwait may agree to incorporate.
4. Insurance companies which the Ministry of Commerce & Industry agrees to incorporate.
5. Information Technologies and Software Development.
6. Hospital and Medicines manufacturing.
7. Land, sea and air transport.
8. Tourism, hotels and entertainment.

9. Culture, information and marketing except for issuance of newspapers and magazines and opening of publishing houses.
10. Integrated housing projects and zone development except for real estate speculation.
11. Real estate investment through foreign investor subscription to the Kuwaiti shareholding companies as per the provisions of law No. 20/2002.

Further, the Council of Ministers Resolution No. 1006/2 for 2003 provides that a license may be issued to a Kuwaiti Shareholding Company (Closed) in which the share of the foreign investor is 100% of its capital subject to compliance with the following terms and conditions:

- (1) The company's capital shall be sufficient to achieve its objects and shall be fully subscribed by the promoters.
- (2) The company shall fulfill the procedures, rules and regulations prescribed under the Kuwaiti Commercial Companies Law No. 15/1960.
- (3) The company shall engage in the activities indicated in the Resolution of the Council of Ministers No.1006/1 for the year 2003. The incorporation of the company should result in the achievement of one or more of the following objectives:
  - A. Transfer of modern technology and administration of practical, technical and marketing expertise.
  - B. Expansion and participation of the role of Kuwait private sector.
  - C. Creation of job opportunities for national labour and contribution to training thereof.
  - D. Support for national products exports.

The new law guarantees protection to the foreign investors against compulsory disinvestment or nationalization by ensuring that any such disinvestment would be against compensation equivalent to the market value prevailing at that time. Further, the rights and privileges acquired by the foreign investor may not be usurped except against payment of compensation. This confirms the commitment of the government to foreign investors and their genuine desire to promote foreign capital investment in Kuwait. This provision is also in accordance with the principle contained in the Kuwaiti Constitution Law prohibiting confiscation of rights without fair compensation.

Further, the provisions of the new law are also extended to existing foreign capital investment to the extent they fulfill the objectives of the new law.

The law permits the transfer of the investment to another foreign investor or to a national investor or assignment of the investment to the national partner in case of a partnership, provided that the transfer is in accordance with the laws and regulations of the State of Kuwait and as per the terms and conditions stipulated in the license granted to the foreign investor for such transfer.

Foreign investors can freely repatriate their profits as well as capital without any restrictions. Any compensation paid on account of disinvestment may also be repatriated.

The privileges that are offered to foreign investors include:

- Tax exemptions for a maximum period of ten years.
- Benefits arising under double taxation treaties and encouragement and protection of investment.
- Total or partial exemption from customs duties on import of specified items such as equipment, machinery, spare parts, raw materials, semi-manufactured goods, packaging materials etc.
- Total or partial exemption from other export and import restrictions.
- Allocation of land and real estate in accordance with the laws and regulations of the State of Kuwait.
- Recruitment of foreign labour required for the project in accordance with the laws and regulations of the State of Kuwait.

## **Taxes**

### **Income Tax Law**

The general rule is that individuals (Kuwaiti or foreign nationals) and Kuwaiti companies are not subject to taxes on income. However, a foreign corporate body engaged in commercial activities in Kuwait is subject to income tax. The tax rates applicable under the Income Tax Law No. 3 for the year 1955 prior to its recent amendment were ranging from 5% to 55%. These rates were applied progressively to income brackets. As per a recent amendment issued to the Income Tax Law (Law No. 2 for the year 2008) a flat rate of 15% will be applied as income tax on the net taxable income. This amendment was passed by the National Assembly on December 26, 2007 and signed by the Amir as Law No. 2 for the year 2008 on February 8, 2008. By virtue of this amendment, the current rigorous tax regime has been replaced with a more liberal one, aimed at market liberalization and attracting foreign investments. In addition to lowering the income tax rates, the profits earned by foreign entities or individuals through trading in shares on the Kuwait Stock Exchange are not taxable under the recent amendment.

### **Contribution to the Kuwait Foundation for Advancement of Science (KFAS)**

The Kuwait Foundation for the Advancement of Science (KFAS) is a private, non-profit organization established by an Amiri Decree on December 12, 1976. The KFAS is managed and administered by a Board of Directors chaired by His Highness, the Amir of the State of Kuwait. KFAS receives financial contributions from Kuwaiti shareholding companies (KSC), amounting to one percent of their net annual profits. The KFAS was established in an attempt to encourage and support

scientific research. KFAS plays a major role in financing scientific research projects undertaken by various scientific bodies. It also cooperates with similar organizations on the Arab and international level.

While as a legal matter a KSC is not strictly speaking obligated to pay one percent of its net profits to KFAS (under Article 48 of the Kuwait Constitution, taxes may be levied only by a duly promulgated law), it has become the general and accepted practice in Kuwait for KSC's to make such payments to support KFAS's beneficial scientific activities. The failure of a KSC to make such payments may result in such KSC facing administrative difficulties in dealing with Kuwait government agencies and instrumentalities. As per a recent directive from the government, payment to KFAS has been temporarily suspended.

### Zakat Law

A new law<sup>14</sup> has been passed by the National Assembly levying Zakat (tax according to Islamic Sharia principles) on all Kuwaiti shareholding companies. According to this law, one percent of the profits of the company are required to be paid to the government as Zakat. The company may select the entity or project to which the payment is to be applied by the government from the list provided under the law.

### National Labour Support Law

Law No. 19 for the year 2000 was enacted in respect of supporting and encouraging national manpower to work in the non-governmental sector. In addition to granting a social and children allowance to nationals and a cash allowance for every unemployed Kuwaiti who is unable to find a job, the law also obligates the government to share the costs of training the national manpower in the non-governmental sector. Article 9 of that law obligates individual entities to adhere to the minimum percentage of national manpower required to be recruited, as determined by the cabinet. Kuwaiti shareholding companies listed on the Kuwait Stock Exchange are also required to pay a tax amounting to 2.5% of their net annual profits. Non-observance or evasion of the same may attract various penalties.

### **Public Sector Procurement**

#### Tenders Law

Procurement by the Kuwait Government and its agencies is governed generally by Law No. 37 of 1964 (modified by Law Nos. 13 and 31 of 1970 and 1977, respectively) concerning Public Tenders (the "Tenders Law"). The Tenders Law provides that any procurement made by the Kuwait Government with a value in excess of KD 5,000 (approximately \$16,500) must be conducted through the Central Tenders Committee procedures in order to ensure competitive pricing.

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14. Zakat Law No. 46 for the year 2006

Article 5 of the Tenders Law provides that tenderers for government contracts must:



"(1) *be a Kuwaiti merchant, individual or company, registered in the Register of Commerce in the Chamber of Commerce and Industry of Kuwait;*

*The tenderer may be a foreigner if he has a Kuwaiti merchant acting as a partner or agent pursuant to a deed duly executed before a notary, provided the Central Trading Committee shall set down a specific regulation for the participation of the foreign company in the tenders of large works.*

(2) *be registered in the Classification List of Contractors and Suppliers in conformity with the following Articles."*

As a result, a foreign entity may act as a government contractor only through a Kuwaiti entity in which it has an ownership interest or by acting directly but with the assistance and support of a Kuwaiti agent or commercial representative.

There are two important exceptions to the application of the Tenders Law:

1. Ministry of Defence Procurement.

The Tenders Law does not apply to the procurement of military items for the Ministry of Defence and Security Forces. "Military materials" is broadly defined by Kuwait law to include land, sea and air weapons and spare parts and military communications and detection equipment and related system ("strategic military procurement").

There are no comprehensive laws or regulations which govern Ministry of Defense ("MOD") strategic military procurement. Instead, the MOD has developed internal policies and procedures for such procurements, and such policies and procedures are not available to the public. In general, such policies are more flexible than the Tenders Law in an effort to accommodate MOD's specialized needs with respect to strategic military procurement.

Prior to the invasion of Kuwait in August 1990, the use of intermediaries or agents in connection with strategic military procurement was discouraged by MOD policy and practice. Ministry Circular No. 4A/88, dated June 8, 1972 provides that, contracts for arms, ammunition and spare parts should be concluded between the MOD and its suppliers directly without the intervention of any agent or intermediary. In practice this circular applies to all procurements by the MOD unless a specific directive is issued by the Ministry which provides otherwise. This policy against intermediaries was often incorporated directly into the contract documents with the foreign vendor.

However, after the liberation of Kuwait the MOD issued some directives specifically requesting the involvement of Kuwaiti agents in certain contracts. The directive, however, did not address the manner in which such agencies would be regulated. Furthermore, a general and vague distinction was made between strategic and non strategic equipment.

In recent years, MOD has gradually returned to its pre-invasion policy of discouraging the use of agents in connection with strategic military procurement. There were recommendations made by the Kuwait Parliament in the spring of 1994 in connection with the approval of the defense budget to the effect that intermediaries should not be allowed in connection with military procurement in

order to reduce the costs of the same to the State of Kuwait. The Kuwaiti Parliament has also questioned the MOD on this issue. The Minister has assured the Parliament that the Ministry's procurements are conducted directly with the foreign suppliers.

Therefore, to conclude, no agents should be involved in military sales unless the agent can show that the specific transaction has been exempted by a specific directive to that effect.

## 2. Other Specialized Procurement.

In addition to strategic military procurement, it is possible for Kuwait government agencies to request permission of the Central Tenders Committee to conduct particular tenders outside the Tenders Law. Because the Tenders Law is intended to ensure competitive pricing for all procurements made by the State of Kuwait, procurements made outside the Tenders Law are relatively rare.

### **Offset Program**

The Government of the State of Kuwait purchases large amounts of goods and services from foreign contractors. This results in economic benefits accruing in foreign countries where the goods and services are manufactured, mainly through job creation and capital accumulation. The Kuwait Counter-Trade Offset Program seeks to achieve equitable distribution of these benefits between Kuwait and the foreign countries. Foreign contractors could also benefit from this program since it would bolster their business activities in Kuwait. Therefore on July 26, 1992, the Council of Ministers of the State of Kuwait established the Counter-Trade Offset Program (Offset Program) through the Decision No. 694 which requires all foreign contractors who meet certain criteria to participate in the Offset Program.

The guidelines issued by the Ministry of Finance for the Counter-Trade Offset Program have been amended from time to time. On March 28, 2006, the National Offset Company was incorporated, which is a State-owned company registered with the Ministry of Commerce & Industry whose primary function is to manage and administer the implementation of the offset program on behalf of the government of Kuwait – Ministry of Finance and in the process facilitate suitable alliances and partnerships between local entities and foreign contractors. The latest guidelines are for Offset Program No. 9 for the year 2007.

According to these guidelines, the offset program seeks to achieve the following objectives:

- *Realize sound and sustainable economic benefits for the State of Kuwait through the promotion of long term links and ventures with foreign corporations with special emphasis on projects implemented in collaboration with the private sector and which contribute to the achievement of the three primary objectives of the offset program, namely*
- *promote projects that lead to the transfer of appropriate advance technologies to Kuwait and facilitate their integration and adaptation into the local economy;*

- *promote projects that contribute to the advancement of professional education and job training;*
- *encourage and support projects that contribute to the creation and development of high skilled professional jobs for Kuwaiti nationals.*

The guidelines also define terms such as “foreign contractor”, “offset obligor” and “offset obligation”. As per the recent guidelines the offset obligation value is equal to 35% of the total monetary value of the supply contract, subject to deductions described therein.

### **Practical Considerations**

1. Foreign entities often mistakenly assume that business is conducted in the Middle East outside the law and fail to educate themselves about the legal system under which they operate and do not seek local legal advice.
2. Often, the actual transactions which the foreign entities enter into bear no relationship to the models envisaged by the legislature and therefore do not conform with mandatory rules; as a result, the transactions are often null and void or unenforceable in Kuwait or expose foreign entities to greater liability than anticipated.
3. In most cases, parties enter into contracts under which a local agent undertakes to import all of a foreign principal's products on an exclusive basis (for the territory of Kuwait), for which the agent normally pays through letters of credit. In effect, this type of contract gives the agent a local monopoly over importation of such products and at the outset shifts the risk of success to the agent. The disadvantage to the foreign entity is that the contract creates a semi-permanent local monopoly in the agent, over which the foreign party has little control and which it cannot terminate except at general expense. For this reason, it is important that foreign entities at the outset properly investigate the local agent's credentials and get local legal advice on the terms of the agreement.
4. Most foreign entities insist on concluding "sponsorship contracts," whereby a local person provides logistical assistance to the foreign company. Although this is a valid contract, it is not a commercial agency agreement and cannot be registered. In practice, what often happens is that the local sponsor gives the application form for agency registration to the foreign company to fill in. This application form requires basic information, and when filed, operates as a commercial agency contract, with terms not covered supplemented by the law. In effect, the foreign company may establish a local agency without knowing it, and on terms and conditions it did not negotiate.
5. For both legal and practical reasons, the choice of a local partner or agent is a critical one. It is therefore essential that the agent's credentials be independently verified. It is not sufficient that an agent be from a "known family" with influence.
6. All Kuwaiti government procurement above KD 5,000 is done through the Central Tenders Committee, and here, as in all markets, quality and price prevail.
7. Termination of a commercial agency agreement must be considered very carefully, and legal assistance is necessary. Although the legal provisions on

termination and non-renewal pertain to public policy and therefore may not be "negotiated out" of an agency agreement, careful drafting of the agreement can minimize their effects.

8. Although there has been considerable progress in implementing Law No. 8 of 2001, so far very few Foreign Investment licenses have been granted. Further, any grant of a license can be made subject to conditions imposed by the Ministry and the entity being granted such a license will be required to provide detailed follow-up on progress made every six months.

9. In order for an application for grant of a license under Law No. 8 of 2001 to stand on its own merits, it must achieve at least one of the requirements prescribed under Resolution No. 1006/2 viz, generate local employment, promote export of goods and services from Kuwait, transfer modern technology or involve the Kuwaiti private sector in the activities to be undertaken in Kuwait.