Company & Commercial - United Arab Emirates

Restrictions on Foreign Ownership of UAE Companies Reviewed

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Background

In recent years countries in the Gulf Cooperation Council (GCC) region, including the United Arab Emirates, have seen a marked increase in foreign direct investment (FDI). The most important factors determining success in attracting FDI, apart from geopolitical risk considerations, are countries' economic fundamentals and the attractiveness of their business environments. In order to address these issues, Gulf countries have:

- reduced the number of industry sectors closed to foreign investors;
- increased the share of foreign ownership in certain sectors; and
- allowed 100% foreign ownership of residential property and other real estate in select areas.

As far as the United Arab Emirates is concerned, the World Bank has identified that the country's statutory requirement for a UAE national partner acts as an impediment to higher levels of investment. In 2006 the World Trade Organization, of which the United Arab Emirates formally became a member on April 10 1996, made recommendations for the United Arab Emirates to allow greater foreign investment in UAE companies outside the free zones.

Limits on Foreign Investment in UAE Companies

UAE federal laws require nearly all types of foreign-owned company to have at least 51% of their shares owned by a UAE national or a company wholly owned by UAE nationals (in the case of some activities, this threshold is even higher). Where these restrictions have been eased at federal level in the past, this has been to the extent of allowing only citizens of other GCC member states exemption from the 51% UAE national shareholder requirement. However, the governments of the individual emirates have sought to encourage FDI by allowing foreign investors 100% ownership of companies operating in the free zones.

Although the free zones offer numerous fiscal advantages, the crucial factor in the proven success of the free zones in attracting FDI is the ability for foreigners to own 100% of their companies in the free zones. However, companies set up in the free zones cannot conduct business onshore (outside the free zones) in the United Arab Emirates without first obtaining the necessary licence, which in turn requires a company to be set up onshore and for such company to have a 51% UAE national shareholder (subject to certain exceptions).

It has been suggested that this distinction between the free zones and onshore United Arab Emirates has created an impediment to greater FDI as it creates two separate and distinct business environments. In addition, the requirement that at least 51% of a UAE company's shares be held by a UAE national has to some extent negatively affected the inflow of FDI into the United Arab Emirates. However, the philosophy behind these restrictions is at least partly explained by the facts that UAE nationals make up a minority of the UAE population and the United Arab Emirates is a major capital exporter. Thus, the restrictions are aimed at guaranteeing and safeguarding the economic interests of UAE nationals, thereby affording them a share in their country's market.

Outside its borders, in the last few years the United Arab Emirates has witnessed its fellow GCC member states easing restrictions on FDI in order to boost the attractiveness of their business environments to foreign investors. They have reduced the number of industry sectors closed to foreign investors and increased the percentage of foreign ownership allowed in certain sectors. Saudi Arabia and Qatar are examples of such states that have opened up additional sectors to foreign investment. However, as far as privatization programmes are concerned, which are known to attract foreign investment, apart from Saudi Arabia, other GCC member states are not actively promoting or developing such programmes to any significant degree, if at all.

Proposed Statutory Amendments

As early as 2005, media reports started to circulate in the United Arab Emirates of statements by Dubai government officials of an impending change to the UAE Companies Law, which would allow increased foreign equity participation in onshore UAE companies. These reports coincided with the start of negotiations in March 2005 for a free trade agreement between the United Arab Emirates and the United States (following the signature of the US-UAE Trade and Investment Framework Agreement in 2004), which was supposed to be concluded in 2006. However, the Dubai Ports World scandal that erupted in the United States in 2006 put the negotiations on hold and the process has not recovered since. US demands included changes to the Companies Law to allow 100% foreign ownership across the country and not just in the free zones.

Previous indications have been that limitations on foreign equity participation may be removed from certain commercial sectors, including:

- professional services;
- computer and related services;
- research and development;
- advertising;
- testing and analysis;
- courier services;
- construction;
- environmental services; and
- tourism.

Some sectors, such as telecommunications, insurance and distribution services, were not included in the aforementioned list for reasons ranging from:

- the size of the national market;
- the need for a long lead time to adapt these sectors to foreign competition; and
- their contribution to the national development efforts.

In addition, this removal of limitations has been indicated to extend to only foreign equity participation of a maximum 75% and to be conditional upon the provision of benefits for UAE nationals in the form of technology transfer, research and development programmes, technical assistance, and education and training.

In one of the most comprehensive local media reports it was stated that, according to then Minister of Economy Sheikha Lubna Al Qasimi, the United Arab Emirates would start to allow 100% foreign ownership of companies in certain areas of the service sector, healthcare and education, while allowing majority foreign ownership (but less than 100%) in some areas of the financial services sector. During 2008, various reports appeared in the local media regarding the intention of the United Arab Emirates to lift restrictions on foreign ownership, which included current Minister of Economy Sultan bin Saeed Al Mansouri stating that as long as foreign investment is useful for the United Arab Emirates, foreigners should be allowed to own these projects, particularly if these business projects involve large amounts of capital and large companies are competing for them. He acknowledged that the issue was sensitive, but that protection of nationals would be guaranteed.

In May 2009 Khalid Al Kassim, the deputy director general of the Dubai Department of Economic Development, was quoted in the media as proclaiming that Dubai was busy promoting more liberal rules on business ownership to the federal government in a bid to counter the negative impact of the economic slowdown. He made it clear that the federal government, as opposed to the Dubai government, would be the authority to announce the new rules and regulations, and he declined to state a timeframe for the introduction of such changes to the law. Following these statements, Abu Dhabi added its voice to the debate and the chairman of Abu Dhabi's Department of Economic Development was quoted in the local media as stating that Abu Dhabi was "strongly inclined to grant 100% ownership to foreigners in new and old industries as well as other projects" and that "the percentage might be less in other sectors according to the Emirate's needs", but that "ownership covers projects and not land". However, he made it clear that no final decision has yet been made.

Although it would appear inevitable that the UAE government will amend the Companies Law to allow for increased foreign equity participation in UAE companies outside the free zones, there is little certainty regarding the exact nature or scope of such amendments and the timing of the implementation thereof, particularly given that no draft of the proposed amendments to the law has been made public for comment.

One school of thought believes that the amendments will identify three categories of foreign investment limit:

- sectors and activities in which the UAE Council of Ministers (Cabinet) may from time to time decide to allow greater foreign participation, up to and including 100% foreign ownership;
- sectors and activities in which the current restrictions on foreign participation would remain (eg, real estate, telecommunications and defence); and
- sectors and activities which would allow increased foreign participation, but less than 100% (eg, trading in consumer goods).

Although this may be mere speculation, the prevailing view appears to be that the law will not be amended so as to encroach on the large businesses built up by UAE nationals and UAE national families.

Impact on Foreign Shareholders of Existing UAE Companies

Whatever the ultimate nature and scope of the amendments to the Companies Law to allow for greater foreign equity participation in UAE companies, foreign shareholders of existing UAE companies may be well advised to review their preparedness for a scenario where one or more of their current and/or future activities in the United Arab Emirates is allowed an increase in foreign participation. In this event the shareholder would need to have the ability to transfer some or all (depending on the level of increased foreign participation which would be allowed for each of its activities) of the shares in its UAE companies from the UAE national who holds such shares to another of its offshore group companies (a limited liability company in the UAE always requires a minimum of two shareholders). This would be achieved by appropriate provisions in its side agreements with such UAE national, and ultimately by way of a trust power of attorney which the UAE national would issue to the foreign shareholder of the UAE company. However, such a power of attorney could be unilaterally revoked by the UAE national, so it is not a fail save. It is thus advisable to have not one UAE national individual as sponsor, but a UAE nationally owned company as UAE national sponsor, holding 51% of a limited liability company set up by a foreign company, which UAE nationally owned company is owned 50/50 by two unrelated UAE nationals. In such an instance the risk of the UAE nationally owned company unilaterally revoking the trust power of attorney is diminished.

There may also be instances where a foreign shareholder would want the UAE national shareholder to retain a small shareholding percentage in order to reward him or her for his or her assistance to the company in obtaining special licences and developing the business in the United Arab Emirates. These instances would ultimately depend on appropriate negotiations with the UAE national.

Given that the majority of foreign-owned limited liability companies in the United Arab Emirates have a UAE national as a trustee shareholder (as opposed to a true participating 51% UAE shareholder), once amendments to the Companies Law make a certain percentage, or all, of such trustee shareholding redundant, a number of foreign shareholders would presumably look to take transfer of all or some of the shares registered in the name of their trustee. The impact of this, and the fact that this could conceivably lead to several disputes between foreign shareholders and UAE nationals who do not wish to give up the sponsorship fees associated with their trusteeship, might be something that the UAE government will consider prior to implementing the amendments to the law. Further procedural rules and regulations might also be issued, which would override or negate the statements above regarding the ability to take transfer of one's sponsor's shares. Furthermore, the Federal Law on the Combating of Commercial Concealment (17/2004), which aims to prohibit side agreements and trust arrangements, and the implementation of which has been postponed until December 31 2009, may also impact on the above if it is implemented (with or without amendments thereto) (for further details please see "Postponement of Anti-concealment Law").

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