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# Introduction to Doing Business in the United Arab Emirates

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**This memorandum reflects the provisions of applicable and publicly available United Arab Emirates company law as of July 2015 and our understanding of both how that law is applied and the current practices and procedures of relevant governmental bodies. It is intended as a general discussion of certain of the principal issues that need to be considered when deciding whether and how to establish a business presence within the United Arab Emirates and should not be relied upon as being a substitute for specific legal advice.**

## Overview

Many countries of the Arabian Gulf contain restrictions on persons who are not nationals of a member of the Gulf Cooperation Council ("**GCC**") from doing business in the country. These restrictions take various forms:

- Limiting, typically to 49%, the percentage of the share capital of a GCC incorporated company that can be owned by a non-GCC national.
- Requiring a non-GCC national to have a "sponsor" before it can register a business or branch in a GCC state.
- Requiring an investment licence (e.g. from the Saudi Arabian General Investment Authority or the Ministerial Cabinet of the Sultanate of Oman) before a foreign person can invest in a GCC country. To encourage foreign investment, these restrictions have been relaxed over the years in a number of respects. For example:
  - In the Kingdom of Saudi Arabia, the restriction on foreign investment has been confined to certain sectors that are expressly listed on the "Negative List" issued by the Saudi Supreme Economic Council (including oil exploration, drilling and production, manufacturing of military equipment, real estate brokerage, audio-visual and media services and recruitment and employment services).
  - Similarly, in the State of Kuwait, locally incorporated companies operating in certain sectors have been exempted from the requirement to have a 51% Kuwaiti shareholder (oil and gas exploration and production is not exempted) and the forthcoming Foreign Direct Investment Law is expected to provide a framework for similar arrangements in the United Arab Emirates.

- Foreign persons may benefit from certain exemptions under free trade agreement between their country of incorporation and certain GCC countries (e.g. between the United States of America and the Sultanate of Oman).
- Certain GCC countries have created a number of free zones which are aimed at enhancing foreign investment in certain circumstances (e.g. Abu Dhabi Global Market, Khalifa Industrial Zone Abu Dhabi, Dubai International Financial Centre, Jebel Ali Free Zone and Qatar Science & Technology Park). Whilst entities established in free zones may have 100% foreign ownership, such entities will generally be limited to operating within their respective free zone or outside the UAE and performing the activities authorised by their free zone licence.

The requirements relating to companies incorporated in the United Arab Emirates ("**UAE**") are governed by the provisions of Law No. 2 of 2015 on Commercial Companies issued on 25 March 2015 (the "**CCL**"). The CCL makes some modifications to the former regime for the establishment of companies in the UAE (e.g. providing for increased minimum share capital requirements for public joint stock companies and private joint stock companies; allowing for limited liability companies to be incorporated by a single shareholder and reducing the minimum number of shareholders for private joint stock companies from three to two and providing that a single corporate person can incorporate a private joint stock company and introducing financial assistance prohibitions for joint stock companies), but largely leaves the framework set out in Law No 8 of 1984 concerning Commercial Companies unchanged.

It should be noted that the many free zones located within the UAE generally have their own rules and regulations regulating the incorporation and management of companies within that free zone. A company incorporated in a UAE free zone would be treated as a foreign company for the purposes of the CCL.

## National Participation Requirements in the UAE

In order to carry on commercial business in the UAE, companies are required to obtain a licence from the federal and/or municipal authorities to carry out their proposed activities. Licences are granted to companies incorporated in the UAE, and to foreign companies operating in the UAE with a local sponsor or through a local agent.

### Companies Incorporated in the UAE

Every company established in the UAE must have one or more UAE national partners (either UAE nationals or companies wholly owned by UAE nationals) whose share in the company must not be less than 51% of its share capital, except for the following:

- companies excluded under a Resolution by the Cabinet if a special provision to this effect is contained within those companies' Memoranda of Association or Articles of Association;
- companies held in full by the Federal or Local Government or any of the establishments, authorities, departments or any companies controlled or held by any of them directly or indirectly, and having at least 25% of the shares of such companies which operate in:
  - oil exploration, drilling, refining, manufacturing, marketing and transmission;
  - the energy sector, electricity generation and gas production; or
  - water desalination, transmission and distribution,

  if a special provision to this effect is contained in the Memorandum of Association or Articles of Association of such companies;

  - Companies exempted from the provisions of Law No 8 of 1984 concerning Commercial Companies and its amendments prior to the effective date of the CCL;

- Companies exempted under special Federal Laws; and
- companies established in one of the UAE's many free zones, if that free zone has enacted special provisions regulating companies established within it (see section 5 below).

The UAE Minister of Economy confirmed at a meeting in March 2015 the government's intention to enact a new Foreign Direct Investment Law that would lower the national participation requirement in certain sectors in the UAE. It is not yet clear when the new law will be published, or which sectors it will apply to.

Certain entities are required to be wholly owned by UAE nationals, including Joint Liability Companies, Simple Commandite Companies and any company falling under a class of activity the Cabinet, based on the proposal by the Minister in coordination with the competent authorities, has issued a decision limiting that field exclusively to UAE nationals.

### Foreign Companies Operating in the UAE

Foreign companies may not carry out commercial activities or establish offices within the UAE except:

- after obtaining a licence from the competent authorities, which requires the foreign company to have a UAE national (or company wholly owned by UAE nationals) as its agent (often referred to as a "**sponsor**") and registering in the foreign companies register at the Ministry of Economy ("**MoE**"); or
- after incorporating a company, or registering a branch or a representative office in one of the UAE's free zones (see below for further details).

The CCL also permits the registration of an office or a branch in the UAE of a foreign company. A branch will be permitted only to engage in activities that its license permits; such activities will largely be limited to activities which are similar to those undertaken by the foreign company, and therefore is only suitable when the activities to be undertaken by the branch and the foreign company are closely related. There is no concept of separate liability for the branch; the foreign company bears all financial liabilities of its branch in the UAE.

It is relatively common for foreign entrants to certain markets in the UAE (e.g. in the oil and gas sector) to be required to establish a branch office as a condition to doing business in the UAE. Local or governmental entities with which foreign companies are transacting may be able to assist with the establishment of a branch or even act as sponsor.

Unlike a partner, the local agent has no equity or management interest in the business and does not bear any of its liabilities. Compensation is typically an annual fee stipulated in an agreement between the sponsor and the foreign company, which is consideration for the agent obtaining and renewing the license and registrations of the branch, obtaining visas and work permits for its staff and assisting it in its relations with governmental departments. The fee will depend on, among other things, the status of the local agent and the image of the foreign company in the local community.

### Distribution of Profits Disproportionately to Shareholding

Certain "side" arrangements have been developed in the UAE to modify the effect of the requirement to have a 51% UAE national partner, i.e. a foreign shareholder could agree that the majority stake in an onshore company will be held by a UAE national but beneficial ownership of such stake is retained by the foreign shareholder pursuant to a declaration of trust or similar nominee arrangement. An "anti-fronting" law was enacted in the UAE in November 2004 which expressly bans such arrangements, although its implementation was subsequently delayed and the current status of the law is unclear. Further, the UAE being a civil law jurisdiction, the concept of beneficial interests, including by way of trusts, is not generally recognised. While we understand that the UAE courts have upheld side arrangements in the past, there is no guarantee that they will continue to do so. In addition, as there is no system of binding precedent for decisions of the UAE courts and decisions are not systematically published there is some uncertainty as to what the courts may decide in the future on a particular case.

There are significant risks associated with adopting a side arrangement structure, namely that:

- the UAE authorities decide to enforce the “anti-fronting” law, which would prohibit the enforcement of any side arrangements; and
- if the relationship with the local majority shareholder becomes strained, it may refuse to sign paperwork relating to the company or may seek to obtain a higher financial return for his involvement in the structure.

The loss of control inherent in having a 51% local shareholder may be mitigated by including provisions in the locally incorporated company’s constitutional documents giving the foreign shareholder enhanced governance rights or the right to receive a greater share of the company’s profits notwithstanding the foreign shareholder’s 49% shareholding. Similar provisions may be included in agreements between shareholders. These arrangements may include:

- providing for the foreign shareholder to appoint the directors of the Company;
- providing for the foreign shareholder to be entitled to a greater share of the profits of a UAE company, through provisions included in the constitutional documents of the company (we are aware of notaries approving documents providing for the distribution of up to 80% of profits to the foreign shareholder);
- putting in place various contractual arrangements designed to enable foreign shareholders to extract value without relying on dividends or trust type structures (e.g. IP licences, service contracts, financing arrangements); and
- mitigating the loss of control inherent in having a UAE national own 51% of the capital of the company through the use of a shareholders’ agreement or deadlock provisions in the company’s constitution. The creation of different classes of shares is not, however, possible except in relation to joint stock companies where determined by the UAE Cabinet.

It may also be possible to limit the scope of the activities conducted by the UAE company in which the UAE national may participate to the supply of goods and services to customers within the UAE only. Other activities could be conducted by a non-UAE company or by a company incorporated (or a branch registered) in one of the UAE’s free zones.

## UAE Free Zones

### Overview

Free zones generally enact their own company laws, independent of the CCL. The rules of most free zones permit foreign companies to (i) incorporate a subsidiary or (ii) register a branch of the foreign company, in each case without the need to appoint a UAE national sponsor or have any UAE national ownership.

There are a number of disadvantages of setting up business in a free zone, including that UAE law treats companies set up in a free zone as foreign companies; accordingly they may not operate outside of the free zone and within the UAE without opening a branch or representative office and appointing a UAE national as sponsor. In practice, some Emirates tolerate free zone companies carrying on certain types of business outside their free zones and in the UAE, although the extent of such tolerance remains unclear and such companies risk operating in breach of UAE law.

The incorporation of a subsidiary or registration of a branch in a free zone can generally be completed more quickly than incorporating a company onshore in the UAE. Depending on the particular free zone, incorporation or registration could take between one week and one month from all required documentation being submitted.

### Branch vs. Subsidiary

The type of entity to be established in a free zone may be influenced by a number of factors:

- The form of the entity must be able to accommodate the proposed business activities; the branch (as would be the case in most jurisdictions) would not be considered a separate legal entity and therefore can only act on behalf of the "parent" entity in business transactions.
- The presence must enable the entity to conduct its daily functions in the UAE, including:
  - renting office space, leasing vehicles, setting up bank account(s) to handle daily expenditures, etc.; and
  - obtaining residence visas for employees and their family members.

  Either a subsidiary or a branch would be permitted to carry out the matters listed above. With respect to obtaining residence visas for employees, this will likely depend on the size of office space rented in the free zone (at present, one residence visa is typically permitted per 10 square metres of office space rented, and the number will be subject to adjustment from time to time).
- A subsidiary established in a free zone would not be considered a UAE or GCC national. If the proposed activities involve the acquisition, ownership or development of assets in the UAE or other GCC countries, there may be restrictions in many GCC countries (including the UAE and Saudi Arabia) on the interests that a foreign (i.e. non-GCC) national may obtain in protected assets (e.g. land and oil and gas resources) or in local companies.

Note that the ongoing administrative requirements may be slightly higher for a subsidiary than for a branch.

## Establishing a Company or Registering a Branch Onshore in the UAE

### Process

Typical steps to establish a company or register a branch office in the UAE include the following:

- obtain a sponsor or a local shareholder and agree the fees payable to the local sponsor / the local shareholder's involvement in the business;
- enter into a sponsorship agreement or agree on a memorandum of association with a local shareholder, notarised by a notary public;
- if incorporating a company, submit application for the establishment of the company to the Department of Economic Development (the "**DED**");
- register trade name;
- obtain Initial Approval Certificate from the DED;
- obtain a Commercial Licence from the DED; and
- if establishing a branch, register the foreign company with the MoE,

depending on the activities to be carried out by the company or branch, there may be additional approvals required from other government entities.

There are a number of specific requirements and documents to be provided to the authorities in connection with these steps, which can be time consuming (e.g. notarisation, attestation and legalisation of documents). It will also be necessary for the new company or branch to lease premises in the UAE prior to completing the incorporation process.

**Types of Entity**

The CCL provides for various types of legal entities to be established in the UAE, the most common forms are public joint stock companies, private joint stock companies and limited liability companies. The CCL also provides for the registration in the UAE of branch offices of foreign companies.

*Timing*

Limited liability companies or branch office: Typically takes at least three months to establish from submission of documents.

Public or private joint stock company: Typically takes at least five to six months to establish from submission of documents.

## Please speak to your Shearman & Sterling contact for further information.

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