The Essential Guide to setting up business in the United Arab Emirates

Dechert LLP

This note provides a summary of applicable and publicly available provisions of United Arab Emirates (UAE) company law as at January 2018 and our understanding of how that law is interpreted. It is intended as a brief introduction to foreign investors who are evaluating the prospects of doing business in the UAE and should not be relied upon as a substitute for specific legal advice.

The UAE was established on 2 December 1971 and is comprised of a federation of seven Emirates namely, Abu Dhabi, Ajman, Dubai, Fujairah, Ras Al Khaimah, Sharjah and Umm Al Quwain as well as numerous free zones (the Dubai International Financial Centre, the Dubai Multi Commodities Centre, the Dubai Creative Clusters Authority, Abu Dhabi Global Market, Khalifa Industrial Zone Abu Dhabi and the Ras Al Khaimah Economic Zone being some of the most commonly referenced free zones). It is based on a civil law regime and the process for setting up business is heavily regulated, requiring not only an assessment of the activities to be conducted, but also an analysis of the proposed geographical location of such activities. Attendances before the Notary Public and various other governmental departments or free zone authorities are also often required and this can be both cumbersome and time consuming.

Whilst the federal laws of the UAE apply across all of the Emirates, each Emirate has its own local laws of civil procedure and evidence. Most of the Emirates also have their own free trade zones. Each free trade zone is subject to the specific laws of that free trade zone along with the federal laws of the UAE and the local laws of the relevant Emirate, where that free trade zone's laws are silent, but there are exceptions.[1]

[1] For example, the Dubai International Financial Centre (a financial free zone within Dubai) has its own body of law, including corporate law, contracts law and employment law, as well as its own court system i.e. it is not subject to the laws of the UAE other than the criminal laws.

Why set up in the UAE?

- Companies in the UAE enjoy one of the least demanding tax frameworks in the world, which can help lessen the financial and administrative strain on international business.
- The UAE has one of the most liberal trade and customs regimes in the Gulf Cooperation Council (GCC) and attracts strong capital flows from across the region.
- The UAE is diversifying its economy and has been witness to sustained growth in the tourism, trade, transportation, science and technology sectors, thereby minimising vulnerability to oil price movements.
- The UAE is strategically placed at the crossroads of the major Eastern and Western economies. The UAE hosts some of the busiest ports and airports in the region making it a logistics hub for international business.
- The UAE has numerous free trade zones, catering to various industrial and business clusters where foreign investors can enjoy 100 per cent ownership, zero corporate taxes (in most cases) and a sophisticated infrastructure.
- The UAE attracts a highly skilled work force due to its liberal labour policies, quality of lifestyle and culture of excellence.
- The extraordinary perception and vision of UAE leaders have created one of the world's most successful and vibrant regions, where locals and expatriates alike coexist harmoniously.

How to establish a legal presence in the UAE

In order to conduct business in the UAE, a foreign investor is required to either establish a formal legal presence within the UAE or use a commercial agent. There are several ways in which this can be done:

- incorporating a local entity;
- registering a branch or representative office of a foreign company;
- establishing a free zone entity; or
- entering into a commercial agency relationship.

Setting up onshore

Local entities formed under UAE Federal Law No. 5 of 1985 promulgating the Civil Transactions Law (as amended) (the UAE Civil Code)

Entities formed under the UAE Civil Code are restricted to carrying out "non-commercial" or civil activities and are typically used by the professions.

UAE Civil Code entities may take one of the three following forms:

- professional services company;
- speculative venture partnership; or
- Mudaraba (an Islamic Shari'a-compliant arrangement).

The professional services company is the most common form of UAE Civil Code entity used by qualifying foreign investors as it can be 100 per cent foreign-owned and is appropriate for carrying on service businesses, such as medical and some consultancy services. One of the main disadvantages of using a professional services company is that it is not considered as a legal entity separate from its foreign owners (it is effectively a sole trader operating under a licence, meaning that the foreign owners will be liable for all of the liabilities of the professional services company). A UAE national service agent must also be appointed to sponsor the professional services company for its licence application and assist in dealings with governmental authorities and other administrative matters. The fees for this appointment are usually paid as an annual lump sum.

Local entities contemplated by UAE Federal Law No. 2 of 2015 promulgating the Commercial Companies Law (the CCL)

All locally incorporated entities (other than those established under the UAE Civil Code) must be set up in accordance with the CCL.

There are five main forms of entity expressly contemplated by the CCL:

- public joint stock company;
- private joint stock company;
- limited liability company (LLC);
- partnership companies; and
- limited partnership companies.

Of the CCL entities set out above, most foreign investors will choose to set up onshore as an LLC or by way of a branch or representative office (please see below).

LLCs

An LLC commonly undertakes commercial, trading and industrial activities and must, by law, have at least 51 per cent

of its shares owned by one or more UAE nationals (or entities wholly owned by UAE nationals) (the Local Partner).[2]

Foreign Shareholder Protections

It is possible to transfer the economic benefit and management control in an LLC from the Local Partner to the foreign shareholder. This can be implemented by way of a series of contractual arrangements, which are customary in the UAE, to govern the relationship between the Local Partner and the foreign shareholder. Such arrangements are put in place to provide the foreign shareholder with a high level of comfort and protection and typically involve:

- a 51:49 split in the registered shareholding of the LLC in favour of the Local Partner, as required by law;
- the allocation of most of the profits of the LLC in favour of the foreign shareholder, as per the constituent documents (this can be as much as 80 per cent in Dubai and 90 per cent in Abu Dhabi);
- allocating the management control of the LLC to the foreign shareholder; and
- transferring the remaining economic benefit of the LLC to the foreign shareholder using documentation, which gives the foreign shareholder some control over the Local Partner's 51 per cent shareholding.

These elements are usually embedded in the constituent documents of an LLC, a private shareholders' agreement and other contractual arrangements.

As the rights of the foreign shareholder are purely contractual, there are risks associated with enforcing an arrangement of this type. However, such risks are generally considered to be low if the correct documentation is put in place and can be further mitigated by the use of professional local companies, which can hold the 51 per cent shareholding.

The LLC is often the preferred business vehicle for foreign investors as it offers a flexible management structure and provides for the protection of minority shareholders. Following the implementation of the CCL in July 2015, there is also now no prescriptive minimum share capital requirement (although it is recommended that the share capital be sufficient to meet an LLC's objectives and in practice, in Dubai and Abu Dhabi, is often required to be anywhere from AED 150,000 to AED 300,000).

Recent developments

Federal Law No. 18 of 2017 came into force on 28 October 2017. This new law has varied parts of the CCL and provides UAE authorities with greater discretion following the previously strict 51 per cent local shareholding requirement. It is not yet certain as to which sectors will benefit from this change, but it is likely to be a driver of further inbound foreign investment into the UAE. Existing foreign investors may also look to take advantage of this new law to enhance their control of existing local LLCs.

Branch and representative offices

Unlike LLCs, branches and representative offices can be 100 per cent foreign-owned, but they can only carry out a restricted range of activities (which usually exclude commercial activities). The range of activities varies from Emirate to Emirate and is subject to policy changes.

The principal difference between a representative office and a branch office is that a representative office is limited to gathering information and soliciting orders and projects to be performed by the company's head office. A representative office is also limited in the number of employees it may sponsor and generally exists to serve as an administrative and marketing centre for the foreign parent company. By contrast, a branch office is considered as a fully-fledged business, that is permitted to perform contracts and conduct other activities, as specified in its licence, in the name of its parent company.

It is a legal requirement that a foreign entity appoints a UAE national service agent for the branch or representative office. Such agent will assist in liaising with the relevant governmental authorities and deal with other administrative matters (but that agent is not permitted to own equity or to participate in the day-to-day running of the business).

Setting up in a free trade zone

The primary benefit of setting up as a free zone entity is that foreign investors can enjoy 100 per cent ownership.

Free zone entities will typically take one of the three following forms:

- a branch or representative office of a foreign company;
- a free zone company; or
- a free zone establishment.

In general, different free zones cater for different commercial sectors. They are often set up with infrastructure and facilities that would be attractive to businesses within that sector in order to encourage investment in those free zones.

[2] Please refer to article 10 of the CCL.

The main disadvantage of a free zone entity is that any entity registered in a free zone, is generally only permitted to conduct business within the geographical boundaries of that free zone and is limited to performing only those activities set out in its licence(s).

Commercial agency

If a foreign investor is proposing to carry out business in the UAE, but does not want to maintain a physical presence in the UAE, it may wish to enter into a commercial agency relationship with a UAE national or an entity owned by a UAE national. Local commercial agents are generally used by foreign manufacturers or traders who are engaged in the large scale importation of goods into the UAE on a regular basis.

Under a commercial agency, the foreign business and the local commercial agent agree to the terms of the sales commission, the territory of the distributorship and the duration of the relationship. Such terms are ordinarily recorded in an agency agreement, which must be registered with the Ministry of Economy in order to be enforceable under UAE law. Once an agreement is registered with the Ministry of Economy, the agent will be entitled to considerable statutory protection under UAE Commercial Agencies Law (Federal Law No. 18 of 1981, as amended by Federal Law No. 14 of 1988 and Federal Law No. 2 of 2010), including but not limited to:

- termination: principals may be restricted from terminating or not renewing registered agreements (even where the agreement is for a fixed term and regardless of the negotiated terms of the agreement itself);
- exclusivity: registered agents have the exclusive right to import the goods, which are the subject matter of the agency;
- commissions: the agent is entitled to commission on all sales made within the UAE (or the individual Emirate to which the relevant agreement relates) regardless of whether or not the agent makes or contributes to those sales; and
- compensation: in the event of termination of a registered agency agreement, the principal may be required to pay compensation to the agent. The amount of compensation payable can vary significantly on a case by case basis.

General considerations

Employment

All onshore employees in the UAE must file labour contracts with the Ministry of Labour and expatriates must be sponsored by their employer. The provisions of such contracts are governed by the local labour law. Of key interest, is the entitlement of the employee to what is known as "gratuity" at the end of service. The formula for calculation of gratuity is complex, however, for employees that have a lengthy period of

tenure with their company, the payout obligation on cessation of employment can be substantial.

Notarisation, legalisation and translation of documentation

In the main, documents originating outside of the UAE will need to be notarised and legalised through diplomatic channels before they are submitted to the UAE authorities. Once the relevant documentation has been legalised, certified Arabic translations of the same will likely need to be produced.[3]

Fees, taxes and other charges

Aside from foreign banks and oil companies, there is currently no corporate or individual income tax levied in the UAE. It is worth noting that there are also no restrictions on the repatriation of profits. As of 1 January 2018, value-added tax has been introduced across the UAE and the GCC and any new entity will now need to register with the Federal Tax Authority of the UAE. Additionally, annual fees are payable to the relevant (i) Chamber of Commerce; (ii) licensing authority / authorities; and (iii) governmental department(s) in order to obtain and subsequently renew business licences. Further fees may also be imposed depending on the number of employees sponsored by an applicant. If established in a free trade zone, there are generally annual licensing tariffs to contend with (which are calculated as a flat fee, plus additional charges for sponsoring and renewing the work and UAE residence permits of employees).

[3] This latter requirement does not apply to free zone licence applicants.

Key contacts

For additional information about conducting business in the UAE, please contact a member of our team in the Dubai office.

Chris P. Sioufi
Partner, Dubai
Corporate
+971 4 425 6330
chris.sioufi@dechert.com

Rodolphe R.A. Pellerin
National Partner, Dubai
Corporate
+971 4 425 6342
rodolphe.pellerin@dechert.com

Nidal Makhoul
Associate, Dubai
Corporate
+971 4 425 6317
nidal.makhoul@dechert.com

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