K&L GATES

ESTABLISHING A BUSINESS PRESENCE IN DUBAI

This guide includes a high-level overview of the legal and regulatory environment for establishing a business presence in the Emirate of Dubai (Dubai), United Arab Emirates (UAE). The overview describes the difference between establishing a presence in mainland (onshore) Dubai and establishing a presence in a free trade zone (free zones).

Furthermore, the guide examines the various forms of commercial entities that can be established and provides an overview of the most commonly used forms to establish a Dubai-based business by foreign investors. It is a summary document relating only to Dubai and is not a substitute for obtaining appropriate and tailored legal advice.

Specific issues that may influence the type of business establishment and its location including the nature of the business, the nationality of the person or entity establishing the business, and whether the business is to be undertaken in Dubai, in other emirates of the UAE or abroad, are not dealt with in detail in this guide.

Businesses considering establishing a presence in Dubai should first discuss their specific requirements with their legal and tax advisers to ensure the appropriate legal form is adopted and the required licenses are obtained. This guide reflects the position as of September 2020, following the introduction of the Foreign Direct Investment Law No. 19 of 2018 and Cabinet Resolution No. 16 of 2020 issuing the "Positive List" (discussed further below), along with the recent introduction of the Economic Substance Regulations and recent amendments to the UAE's Anti-Money Laundering/Anti-Corruption Legislation.

This guide has been prepared during the COVID-19 pandemic; as such, it does not seek to address the issues relating to the impact of the ongoing crisis.

The Business and Legal Environment

Federal Law No. 2 of 2015 concerning Commercial Companies (the Companies Law) sets out the five forms of companies from which a party wishing to establish a business presence in mainland Dubai must choose. In addition, an appropriate commercial or industrial license must be obtained from the relevant governmental authority prior to the entity commencing commercial activities. Certain business sectors (such as financial services and petrochemicals) may also require further approvals from various ministries and/or other authorities that regulate specific sectors.

There are certain restrictions on foreign ownership for investors wishing to establish a company in mainland Dubai. To facilitate foreign investment, a number of free zones have been established and provide an alternative to establishing a business under the Companies Law in mainland Dubai.

The main advantages for foreign investors of operating in a free zone rather than in mainland Dubai are:

- There is generally no tax on profits, subject to certain time restrictions
- In most cases, 100 percent foreign ownership is permitted
- For the most part, the regulations governing free zones are published in English
- There are no restrictions on foreign exchange or repatriation of capital (in certain free zones) Operational support and business continuity facilities are readily available

A significant disadvantage of operating from within a free zone is that businesses are restricted as to the type of activities they may conduct outside of that free zone. An overview of some of the major free zones in Dubai is provided later in this brochure.

Having said that, in 2018, the UAE issued Federal Law No. 19 of 2018 Regarding Foreign Direct Investment (FDI Law) aimed at opening up the UAE mainland market to foreign investors in certain sectors of the economy where up to 100 percent foreign ownership of companies in mainland Dubai would be allowed. In July 2019, the UAE introduced the relaxation of foreign ownership restrictions for 122 business activities, specifically in the manufacturing, agricultural and services categories, pursuant to the FDI Law. This was followed by the UAE Cabinet issuing Cabinet Resolution No. 16 of 2020 containing the full Positive List of economic sectors and activities and the requirements for establishing FDI companies in mainland UAE. Some of these requirements include (i) minimum share capital for some activities, (ii) obligations to employ advanced technology in respect of certain activities; and (iii) compliance with certain Emiratization requirements (Emiratization is an initiative by the UAE government to employ its citizens in the public and private sectors).

FIVE
forms of companies permitted by the COMPANIES LAW

1. Limited liability company
2. Public joint-stock company
3. Private joint-stock company
4. Partnership company (general partnership)
5. Limited partnership company (simple liability partnership)

Establishing a Business Presence in Mainland (Onshore) Dubai

The Companies Law applies to all companies, branch offices, and representative offices of foreign entities established and operating in mainland Dubai (i.e. outside the free zones).

The five forms of companies permitted by the Companies Law are:

1. Limited liability company
2. Public joint-stock company
3. Private joint-stock company
4. Partnership company (general partnership)
5. Limited partnership company (simple liability partnership)

Limited liability companies, public joint-stock companies and private joint-stock companies are the most commonly established types of legal entities in the UAE and are also the most commonly used or invested in by foreign investors. An overview of these three forms is provided below. Partnership (general and simple liability) companies are not commonly used in the UAE for several reasons, including the restrictions on foreign ownership and foreign management.

Alternatively, instead of establishing a local legal entity, a foreign business can carry out certain activities in Dubai through a representative office or a branch of a foreign company as will be further explained in this guide.

Non-commercial activities (including professional services) may be carried out through a civil company or a sole proprietorship, which both have unlimited liability.

Limited Liability Company

The limited liability company (LLC) is the most widely used form of company by foreign investors looking to conduct commercial activities in Dubai. An LLC is a private company and its shares cannot be offered to the public. Shareholders of an LLC benefit from limited liability status.

An LLC has a separate legal capacity that is independent of its shareholders. The liability of each shareholder to the other shareholders and to third parties is limited to such shareholder's capital contribution to the LLC. The objects of an LLC must not include insurance, banking, or investment of funds for the account of third parties. An LLC must have an initial capital sufficient for it to achieve its objectives, and the founders of an LLC have the right to determine the amount of such initial capital.

An LLC is required to have at least 51 percent of its shares held by UAE nationals or companies wholly-owned by UAE nationals. An LLC may also have 100 percent of its share capital owned by Gulf Cooperation Council (GCC) nationals; however, if any non-GCC national becomes a shareholder in the LLC, the minimum 51 percent UAE national ownership must be complied with.

The new FDI Law introduces an exception to the above requirement by providing that if the LLC can satisfy the requirements of the FDI Law and the Positive List, there is then no need to have a UAE national majority shareholder.

Historically, a practice of entering into certain side agreements has developed in the UAE in relation to the UAE national ownership requirements. Pursuant to such side agreements, UAE shareholders agree to assign their profits to the foreign shareholders in an LLC in return for an agreed annual fixed fee. The enforceability of such side agreements is not certain, and the prudent view is that a UAE court might consider such side agreements as an attempt to circumvent UAE ownership requirements in breach of the Companies Law and the UAE Federal Law No. 17 of 2004 concerning the Combating of Commercial Concealment, as amended (the UAE Anti-Fronting Law). The UAE Anti-Fronting Law technically entered into force on 31 December 2009 and criminalizes the practice of enabling a foreign national to conduct an economic or professional activity prohibited or restricted by UAE laws and regulations.

The Companies Law, however, permits shareholders of an LLC to agree on a disproportionate economic benefit split that deviates from their shareholding ratio. Profits and losses of an LLC may therefore be distributed disproportionately among the shareholders (including where the shareholders are both UAE and foreign nationals). The ratio should be set out in the LLC's memorandum and articles of association, provided that not less than 20 percent of profits are distributed to the UAE national shareholders.

The management of an LLC may be comprised of either a single manager or a management board (functioning as a director and board of directors, respectively, would in other jurisdictions). Generally, there are no nationality requirements regarding the composition of the board.

Specific conditions may be required to form an LLC in mainland Dubai. These conditions depend on the nature of activities to be conducted by the company. It should be noted that certain activities are restricted to those companies that are fully owned by UAE nationals (e.g., commercial agency and supply of labor).

Additional approvals from other local or federal authorities may be required before obtaining a license from the Dubai Department of Economic Development (Dubai Economy), depending on the nature of the activities that are to be carried out by the company. For example, a company looking to carry out certain telecommunications activities will need to get prior approval from the UAE Telecommunications Regulatory Authority.

Public Joint-Stock Company

Public joint-stock companies are required to have at least five founding members (unless founded by the UAE federal government or the government of one of the seven Emirates that make up the UAE, or unless it is the result of a conversion of any company into a public joint-stock company), and an initial capital commitment of AED30 million (approximately US$8.2 million). The articles of association of the company may provide for an authorized share capital, which may be up to two times the issued share capital of the company. The capital of a UAE public joint stock company is required to be divided into negotiable shares of equal value. The nominal value of each share must not be less than AED1 (approximately US$0.27) or exceed AED100 (approximately US$27). All of the company's shares must have equal rights and must be subject to equal obligations. Partly paid shares are permitted, provided that at least 25 percent of their value is paid upon their issue and the remainder of their nominal value is paid up within three years of such issue. Between 30 percent and 70 precent of shares must be offered to the public. With the exception of shares in public joint-stock companies wholly-owned by the UAE federal government or the government of one of the Emirates, shares in all public joint-stock companies must be listed on a securities market in the UAE (the Dubai Financial Market or the Abu Dhabi Securities Exchange).

A public joint-stock company has a separate legal capacity independent of its shareholders. Like LLCs, 51 percent of the share capital of public joint-stock companies must at all times be held by UAE nationals. GCC ownership also satisfies the UAE ownership requirements in public joint-stock companies, although the articles of association of a particular public joint-stock company are capable of providing otherwise.

A public joint-stock company is required to have an odd number of directors, which may be between three and eleven; each director is elected for a term of three years and may be re-elected for further three-year terms. The chairperson and a majority of the board of directors must be UAE nationals. At least two-thirds of the directors must be shareholders of the company.

A public joint-stock company cannot provide financial assistance to any shareholder.

Private Joint-Stock Company

A private joint-stock company requires at least two founding members and a minimum initial capital commitment of AED5 million. As an exception to the rule, the law permits the incorporation of sole shareholder private joint-stock companies, known as "sole proprietorship – private joint stock" entities. A private joint-stock company may not have more than 200 shareholders. Shares in private joint-stock companies may not be offered for public subscription. In all other respects, provisions of the Companies Law applicable to a public joint-stock company also apply to a private joint-stock company. A private joint-stock company may be converted into a public joint-stock company. Private joint-stock companies with more than 75 shareholders must comply with corporate governance rules.

Branch or Representative Office of a Foreign Company

Foreign companies are permitted to establish wholly-owned branches and representative offices in Dubai. The primary difference between a branch and a representative office is that a branch may carry out activities similar to those of its parent company and generate revenue in the UAE. By contrast, a representative office may only promote its foreign parent company's activities by gathering information and soliciting orders but may not carry on its parent company's activities.

The scope of activities that may be carried out through a branch of a foreign company is limited to those activities permitted by the UAE Ministry of Economy from time to time, which have traditionally excluded trading of goods in addition to certain other service activities.

A branch or a representative office is not considered a separate legal entity from its parent company. The liabilities of a branch or representative office therefore attach to the foreign parent company establishing it.

Generally, foreign companies are required to appoint a local service agent for licensing and registration of a branch or a representative office in the UAE. The local service agent must be a UAE national or a company wholly-owned by UAE nationals.

Unlike a shareholder, a local service agent has no equity or management interest in the branch or the representative office and does not bear any of its liabilities or obligations.

The compensation of a local service agent is typically an annual fee stipulated in a local service agency agreement between the local service agent and the foreign company, in consideration for certain administrative and licensing assistance that the local service agent may perform for the branch or the representative office.

External approvals from other authorities may also be required before obtaining a license and a registration certificate from Dubai Economy, depending on the nature of activities to be carried out by the branch.

In general, annual fees are due to the relevant authorities for the renewal of licenses and certificates of registration, in addition to the one-time establishment fees paid at the outset. There are also other incidental fees relating to the issue and maintenance of immigration, labor, and residency permits. Moreover, office space needs to be leased within mainland Dubai in order for a license to be issued by Dubai Economy to any entity operating in mainland Dubai.

The Free Zones

Numerous free zones have been established in Dubai, each with its own individual industry focus and regulatory environment. Businesses operating in the free zones are not subject to many of the restrictions imposed by federal and local laws and regulations. The following are some of the more well-known free zones established in Dubai:

- **Jebel Ali Free Zone (JAFZ)**
  Located next to the largest port in the Middle East, JAFZ is primarily targeted at import and export businesses..
- **Dubai International Financial Centre (DIFC)**
  Primarily for financial services providers, the DIFC has its own legal system, courts, financial services regulator (the Dubai Financial Services Authority), and stock exchange (NASDAQ Dubai).
- **Dubai Development Authority (DDA)**
  Principally for business activities that are related to information technology, e-commerce, media, printing and publishing, media production, broadcasting, information agencies, training and education, DDA acts as an umbrella to a number of smaller and more specialized free zones such as Dubai Media City, Dubai Internet City, Dubai Knowledge Village, Dubai Production City, Dubai Studio City, and Dubai Outsource City.
- **Dubai Healthcare City**
  Provides quality healthcare and an integrated center for clinical and wellness services, medical education and research.
- **Dubai Multi Commodities Centre (DMCC)**
  A commodity market place, providing industry specific market infrastructure and a full range of facilities for the gold and precious metals, diamonds and coloured stones, energy, and other commodities industries. DMCC is also home to a general free zone for non-commodities-related business that has become increasingly popular in recent years.
- **Dubai Airport Free Zone (DAFZ)**
  A general trading, import, and export free zone located next to Dubai International Airport.
- **Dubai Silicon Oasis (DSO)**
  A high-tech free zone for the micro-electronics and the semiconductor industries, amongst other IT and technology sectors.
- **Dubai Logistics City (part of Dubai World Central) (DLC)**
  A logistics-oriented free zone catering to all transport modes, logistics businesses, and value-added services, including light manufacturing and assembly, DLC is located near Dubai's Al Maktoum International Airport.

The type of business activity to be undertaken will dictate which free zone is appropriate in light of both commercial and regulatory considerations. Further information on these and other free zones can be provided on request.

Establishing a Business Presence in the Free Zones

The free zones operate independently of each other and each has its own Free Zone Authority (FZA), responsible for issuing the necessary licenses to operate in its respective free zone. As each free zone is different, it is necessary to liaise closely with the relevant FZA in order to determine its particular requirements.

An individual or entity wishing to operate in a free zone will need to establish an operating entity to carry out its business. The type of legal entity that may be established differs in each free zone. Broadly, the following are the most common types of entities that may be established in the free zones:

- **Free Zone Establishment (FZE)**
  An FZE may have only one shareholder and holds separate legal capacity from its shareholder.
- **Free Zone Company (FZCO or FZ-LLC)**
  An FZCO or FZ-LLC is similar to an FZE with a separate legal capacity independent of its shareholders. However, in contrast to an FZE, it may have more than one shareholder.
- **A Branch Office of a Foreign or Local Company**
  A branch office of a foreign or local company is not considered a separate legal entity from its parent. The liabilities of a branch of a foreign or local company attach to the parent company establishing the branch office.
- **A Private Limited Company in the DIFC**
  A private limited company holds separate legal capacity and may have one or more shareholders. There is no minimum capital requirement for the establishment of a DIFC private limited company and the capital is divided into transferable shares.

... businesses operating in the free zones are not subject to many of the restrictions imposed by federal and local law and regulations.

- **An Offshore Company in JAFZ**
  An offshore company in JAFZ may have one or more shareholders and holds separate legal capacity from its shareholders. An offshore company cannot carry on business with companies or individuals resident in the UAE, and no residency permit or any kind of visas can be issued to an offshore company. There is no minimum capital requirement for the establishment of an offshore company. While it is not required that an offshore company maintains a physical existence or office in JAFZ or Dubai, it is permitted to do so. It is also permitted to maintain a bank account in Dubai (inside or outside the free zone). An offshore company is required to appoint a registered agent approved by the FZA.

Setting up a free zone branch is often the simplest option to establish a business presence in a free zone, although consideration should be given to the desirability of ring-fencing liability within a new company with limited liability. As noted above, depending on the particular free zone, there are minimum capital requirements for incorporating free zone establishments and companies.

The types of licenses that will be granted by the relevant FZA will depend on the type of industry serviced by the free zone. The licenses include trade licenses, industrial licenses, retail licenses, service licenses, warehousing licenses, and professional service licenses.

Annual fees are due to the relevant FZA for these licenses together with a one-off set up fee. There are other incidental fees relating to immigration and, where applicable, an annual rental payment for office or industrial space. The licensing fees are subject to change by the relevant authority and are dependent on the free zone and the type of license applied for. A discussion with the relevant FZA regarding the type of license required and any applicable fees should be held at the outset.

Other Legislative Changes to Consider When Establishing a Business in Dubai

Data Privacy Protection Laws

The UAE does not have a comprehensive data protection law at its federal level. However, there are a number of laws in place that govern privacy and data security. In December 2019, the UAE Cabinet confirmed that it was planning to take steps to strengthen consumer protections across the UAE, particularly with respect to e-commerce transactions.

In Dubai, the DIFC Authority and the Dubai Healthcare City Authority have passed comprehensive laws and regulations regarding data protection laws, the most recent being DIFC Law No. 5 of 2020 which provides an updated data protection regime and came into effect on 1 July 2020. Entities established in free zones are required to follow the laws and regulations of their respective free zones and other federal laws as applicable to the free zone entities.

Value-Added Tax in the UAE

Value-Added Tax (VAT) was introduced in the UAE on 1 January 2018 at 5 percent on several goods and services.

There are three categories for VAT in the UAE: the standard 5 percent VAT, zero-rated supplies and exempt supplies.

The Federal Tax Authority is responsible for administering, collecting, and enforcing federal taxes. It also provides guidance and conducts audits.

Companies that have an annual turnover above AED375,000 are required to register for VAT. Those that have a turnover under AED375,000 but above AED187,500 can voluntarily register for VAT.

VAT applies equally on tax-registered businesses managed in mainland UAE and in the free zones. However, if the UAE Cabinet defines a certain free zone as a 'designated zone', such free zone is treated as outside the UAE for tax purposes. The transfer of goods between designated zones are tax-free.

Economic Substance Regulations

The UAE Cabinet of Ministers Resolution No. 31 of 2019 Concerning Economics Substance Regulations (ESR) was issued on 30 April 2019 in response to an assessment by the European Union of the UAE's tax framework in light of the European Union's Code of Conduct Group on Business Taxation. The ESR specifies the requirement for all companies in the UAE (including those in all free zones) to have economic substance or a presence in the UAE.

The ESR apply to companies that generate income by undertaking one or more of the "Relevant Activities" identified by the ESR, which include:

1. Banking business
2. Insurance business
3. Investment fund management business
4. Lease-finance business
5. Headquarters business
6. Shipping business
7. Holding company business
8. Intellectual property business
9. Distribution and service centre business

A Relevant Activities Guide was issued by the Ministry of Finance to provide more information on each Relevant Activity, the relevant Core Income-Generating Activities (CIGAs) and examples for each Relevant Activity. Companies that carry out one or more of the above activities must maintain actual economic substance and must submit an annual compliance report/notification to the relevant regulatory authority, which should include the information set out in the ESR and the published guidance demonstrating to the authority that the company maintains actual economic substance.

One of the requirements to demonstrate economic substances (if a company carries out one or more Relevant Activity) under the ESR is that a company needs to undertake one or more CIGAs relevant to its Relevant Activity or Activities in the UAE. CIGAs are activities that are fundamental to a company for generating income from one or more Relevant Activity. Other ways that a company can demonstrate economics substance is by satisfying the requirements as to having an adequate number of employees, physical assets and expenditure in the UAE.

If a company determines that it did carry on a Relevant Activity, and if it received income from such activity during the latest financial year, it is expected to file an Economic Substance Return within twelve months from the end of the relevant period. This is a secondary submission to the ESR report/notification that must be made, which will need to demonstrate that, in generating that income from the Relevant Activity, the company did so with appropriate economic substance in the UAE.

Failure to meet the economic substance test or to provide information (or provide inaccurate information) results in significant penalties.

Anti-Money Laundering Legislation

New Anti-Money Laundering Regulations were issued on 29 January 2019 pursuant to Cabinet Resolution No. 10 of 2019 (AML Regulations). The AML Regulations provide guidance on the operation of UAE Federal Decree-Law No. 20 of 2018 on Anti-Money Laundering and Combating the Financing of Terrorism and Financing of Illegal Organizations (AML Law). The AML Regulations specify that only those entities that qualify as financial institutions or designated non-financial businesses and professions (DFNBP) will be subject to the obligations of the AML Law. Therefore, businesses operating in the UAE, which fall within the above categories, must consider the application of the AML Law and AML Regulations to their business and ensure that they have internal processes in place to identify, manage, and mitigate high-risk customers and activities.

Finally, businesses considering establishing a presence in Dubai must first discuss their specific requirements in detail with their legal and tax advisers to ensure that the appropriate structure is adopted and the required licences are obtained.

The structure to be used by a business seeking to establish in Dubai is dependent on a number of legal, licensing, and tax considerations, and the level and location of the business that is likely to be transacted in the region. The above is only a brief summary of the key considerations. We are happy to provide more specific advice on request.

ABOUT K&L GATES

K&L Gates delivers legal services on an integrated and global basis, with lawyers located across the Middle East, Asia, Australia, Europe, South America, and the United States.

Our Dubai office is located in the Dubai International Financial Centre. The office advises local and international corporations active in the United Arab Emirates and throughout the Middle East, North Africa, and South Asia, with particular emphasis on corporate and commercial transactions, mergers and acquisitions, investment funds, financial services regulatory advice, banking and finance, infrastructure projects, construction, and dispute resolution including arbitration.

The lawyers in our Dubai office have considerable experience and industry connections and can also leverage the proven capabilities of their colleagues based in Doha, Qatar, and throughout the firm's extensive network of offices. With strong presence in key capital cities and commercial and financial centres, our global network of legal resources allows us to offer strategic counsel on a variety of issues around the world. Please contact us directly for more information on how we may be able to assist you or your business.

Learn more about our Dubai office at klgates.com.

Contacts:

Tony Griffiths
Managing partner, London, Brussels, Dubai, and Doha offices and
Managing Partner, Europe and Middle East
tony.griffiths@klgates.com
+44.(0)20.7350.8195

12431

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