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Legal update
United Arab Emirates
Corporate law
Foreign ownership restrictions
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100 percent foreign ownership in onshore UAE; effective change or more of the same?

The United Arab Emirates' (**UAE**) cabinet recently announced that it has passed a resolution to relax existing onshore foreign ownership restrictions. This development will likely affect not only businesses established onshore but also those operating from one of the many free zones in the UAE. As of now few details have been released. Still, considering how fast the UAE legislature can move to implement new laws and regulations – as we have seen in 2017 when the UAE rushed to implement its VAT system – it is worthwhile to now consider the potential impact of this new resolution. According to press releases, the relaxation of foreign ownership restrictions will come into effect at the end of 2018. In this brief legal update, we outline existing restrictions and possible implications of the new regulations for businesses active in the UAE.

Current situation

Article 10 UAE Federal Law 2/2015 on commercial companies requires that at least 51 percent of the share capital in any company incorporated onshore in the UAE must be held by UAE nationals or UAE entities, the beneficial owners of which are UAE nationals only. Different provisions exist for joint stock companies.

Foreign investors often do not find full and effective partners in the UAE and are reluctant to relinquish control over their subsidiaries. Therefore, many foreign investors have implemented contractual mechanisms to protect their interests in UAE onshore companies.

A system has developed in which foreign investors engage a silent partner who – while being the nominal holder of 51 percent of the share capital – does not effectively share in the profits and losses or management of the UAE company. While this structure is widely used in practice, many investors have chosen arrangements which would not hold up in court if tested. Therefore, relaxation of foreign ownership restrictions is a welcome step that would provide legal certainty for a practice that is already in reality well-established in the UAE market.

What has happened so far?

With Federal Decree 18/2017 – issued in September 2017 – the UAE government indicated that a relaxation in the foreign ownership restriction may be forthcoming. The decree provided that the UAE cabinet may issue a resolution to determine the activities and companies in which a foreigner may own all or the majority of the share capital.

It appears that the UAE cabinet has now exercised this authority. Further details are not yet available. Thus, it remains to be seen whether the relaxation will be compressive or limited to certain types of entities and/or sectors. By way of comparison, in Saudi Arabia and Oman, the sector determines the percentage of foreign ownership permitted.

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The UAE cabinet has made it clear that the lifting of foreign ownership restrictions aims to stimulate the UAE economy and shall facilitate investment in specific sectors. This scope is in line with the proposed introduction of long-term visas of up to 10 years for investors, professionals and students in certain fields such as health care, technology and research and development. Thus, it is likely that the UAE legislature will follow the examples of Oman and Saudi Arabia and lift or relax foreign ownership restrictions only in certain sectors.

The UAE government has stated that it will release additional information on the proposed relaxation in the third quarter of 2018 as part of an implementation plan. Some issues should, however, already be considered:

Limited liability companies

The corporate entity most frequently used by foreign investors in the UAE onshore is the limited liability company (**LLC**). Foreign investors should revise the corporate documents of their UAE onshore subsidiaries to ascertain whether these provide for mechanisms that would compel the local shareholder to sell his/her shares to the foreign investor. While such mandatory transfer provisions are commonly used, it remains to be seen how these would be treated in practice. UAE law does not prohibit these clauses. Still, it is to be expected that the UAE national shareholder's co-operation will be needed for a transfer of the 51% holding in practice. Therefore, foreign investors should expect a commercial negotiation in relation to any such restructuring.

Furthermore, foreign investors may not be able to fully acquire said shares owned by the UAE national directly. Currently UAE Federal Law 2/2015 on commercial companies only allows a single UAE national shareholder to hold all of the share capital in an LLC. Unless this provision is amended to include foreigners, foreigners will not be able to (directly) acquire all of the shares of their UAE partner. They will have to either find a new partner to take over the shares or part of the shares currently held by the UAE partner, or use a second vehicle to acquire the shares.

Joint stock companies

The foreign ownership restrictions are somewhat different where – open and closed – joint stock companies are concerned. It remains to be seen whether the UAE legislature will amend the provisions governing foreign shareholding in joint stock companies.

Branches

At least in part due to the foreign ownership restrictions, some foreign investors choose to engage in the UAE onshore market through a branch of a foreign company, rather than incorporating a UAE subsidiary. A branch of a foreign company under the current law only requires a local sponsor who has no share in the business of the branch. Since under UAE law a branch is not a separate entity, it has one key disadvantage compared to a subsidiary: the branch does not limit the liability of its parent company. Therefore, investors who choose to establish a branch to avoid engaging a local shareholder may wish to revisit that decision in the future, particularly since the UAE legislature thus far has not indicated whether the new legislation will permit UAE branches of foreign companies to operate without a UAE national as a sponsor.

Free zones

One of the key factors enticing foreign investors to set up in one of the UAE's free zones is that they allow 100 percent foreign ownership. If the the new legislation allows full foreign ownership in all sectors onshore, this will clearly affect the attractiveness of free zones. However, there are other advantages for free zone entities, including customs and duty exemptions, and a tax-free period granted under Emirati law. Since the UAE legislature is contemplating introducing a corporate income tax, these other advantages of free zones may become more pronounced.

Corporate income tax

The UAE Ministry of Economy has announced that it is considering implementing a federal corporation income tax. Other GCC countries that already impose corporate income tax – such as Saudi Arabia and Qatar – only tax profits incurred by foreign shareholders. No details on the UAE government's proposals for corporation income tax have been published yet. Therefore, it remains to be seen whether the imposition or rate of such tax would be linked to foreign ownership. Furthermore, as pointed out above Emirati law provides tax-free periods for entities established in a free zone. Thus, it will be interesting to see how these laws will be measured against a pending federal income tax law.

Impacts

Regardless of the extent to which the foreign ownership restrictions will ultimately be relaxed, the UAE is taking a significant step in its move to modernize its legal landscape. The approach is in line with significant developments in the UAE's legal regime over the last three years, including a new commercial companies law, a bankruptcy law, VAT legislation and a new arbitration law that was signed in mid-May.

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