



ESTABLISHING A BUSINESS IN THE UNITED ARAB EMIRATES:

A SUMMARY OF THE BUSINESS ENVIRONMENT, COMMERCIAL AGENCY AND COMMERCIAL COMPANIES LAWS

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I. INTRODUCTION: BACKGROUND; BUSINESS AND LEGAL CLIMATE

Strategically located between Europe and Asia, the United Arab Emirates has become the headquarters of choice for hundreds of multi-national public and private companies doing business in the Middle East, the Commonwealth of Independent States (“CIS”), Central Asia, India and Africa. Abu Dhabi, the U.A.E. capital, plays the central role in the U.A.E.’s economy. The country is comprised of seven emirates (Abu Dhabi, Dubai, Sharjah, Ras Al Khaimah, Fujairah, Umm Al Qaiwain,), each having a certain degree of local autonomy similar to the relationship existing between a Canadian province and the Canadian federal government. Abu Dhabi and Dubai are the U.A.E.’s two business and economic powerhouses.

Abu Dhabi, the largest of the emirates in terms of land mass and the second largest in population, is known worldwide for its significant oil and gas reserves (9.5% and 4% of the world’s proven reserves respectively) and as a regional banking and investment center. The Al Nahyan family, traditional rulers of Abu Dhabi, are spearheading efforts to broaden Abu Dhabi’s economic base to include a diverse range of industrial and commercial activities. This range of activities includes privatization of government-owned enterprises and utilities (i.e., water & power, gas & oil, satellite communications, computer hardware and computer software), investment in the banking and investment services sectors, and promotion of tourism. Abu Dhabi’s future plans also include the establishment of tax and customs free zones (i.e., Industrial City) – with a particular emphasis on industrial free zones - and dramatic revisions to its current company and commercial laws in addition to aggressively promoting foreign direct investment.

Dubai, the second largest emirate in terms of land area and first in terms of population, maintains world-class seaport and airport facilities, served by all leading international shipping agencies and airlines. Dubai’s economy is highly diversified, with 84% of its Gross Domestic Product attributable to non-oil business sectors. Tourism, trade, transport and distribution, construction, manufacturing, finance and the services sectors provide the key underpinning to Dubai’s surging economy. Dubai’s visionary government has achieved international acclaim for the free zone industry that has been emphasized in the emirate for over twenty years. The government established the Jebel Ali Free Zone (“JAFZ”) in 1985, which contains an off-shore jurisdiction as well as the more common “brick and mortar” free zone jurisdiction. Thousands of companies have registered in JAFZ over the years, with a special emphasis on trans-shipment and light manufacturing operations. JAFZ’s success was followed by the creation of 19 other free zone areas, the most prominent of which are Internet City, Media City, Dubai Airport Free Zone and the recently established Dubai International Finance Centre. Companies establishing operations in free zones have the benefit of drastically stream-lined incorporation procedures and residency visa issuance, which take far less time to navigate than the requirements for establishing traditional “on-shore” companies in Dubai. Free zones companies must comply with local laws, including agency nomination laws and customs regulations, if their activities include selling products or services inside the U.A.E. market. (Further discussion of free zones is included below.)

In addition to the numerous free zones established in Abu Dhabi and Dubai, the government of the emirate of Ras Al Khaimah recently established a free zone area – which also includes the U.A.E.’s second off-shore jurisdiction. Abu Dhabi is also introducing additional free zone jurisdictions in the near term and the emirates of Fujairah, Ajman, Umm Al Qaiwain, Ras Al Khaimah and Sharjah all have established free zones. The U.A.E. is deeply committed to continuing its policy of drawing in foreign direct investment through similarly innovative incentives such as tax holidays (discussed below), reduced or eliminated customs duties, and subsidized lease rates for land.

Taxation

Although U.A.E. law provides for taxation, no personal or corporate income taxes are directly levied in any of the emirates or the various free zones dotting the country. Free zones offer investors written guarantees protecting this tax-free status decades into the future. Corporations operating in certain sectors are subject to income taxes in the U.A.E., such as courier companies, oil companies, and branches of foreign banks. Many observers have concluded that a Value Added Tax (“VAT”) scheme will be instituted within the near term by Emirati decree. It is anticipated that introduction of the VAT will follow a phased-in approach, applying first only to certain categories of luxury goods and other non-commodity categories of products, at differing tax rate levels, implemented over a course of years throughout a reasonable transitional period. No announcements confirming the institution of a VAT have been made as of the date of this writing.

Exchange Controls

The U.A.E. dirham (the “Dirham” or “Dhs.”) is pegged to the U.S. dollar (the “Dollar”) at the rate of about 3.67 Dirhams per Dollar, and never fluctuates significantly from this level. Due to the strength of the local economy, the large foreign currency reserves, the lack of advanced financial currency products and restrictions on foreign share ownership, the dirham generally has not been attacked by foreign speculators and is generally perceived to be a safe currency. Pressure is mounting to de-link the Dirham from the Dollar in order to allow more independence in economic policy decision-making, particularly in the key area of controlling the country’s carefully watched inflation rate. Certain members within the Gulf Cooperation Council (“G.C.C.”), the six-country economic union in which the U.A.E. was a founding member, have pledged to move to a common currency by 2010.

There are no foreign exchange controls in the U.A.E., and there are generally no restrictions on repatriating capital and/or earnings. In an attempt to control problems of money laundering, banks are supposed to detail all transactions in excess of Dhs. 40,000 under reporting procedures administered by the Central Bank, although pre-approval for such transactions to take place is not required.

Customs

Imports to the U.A.E. generally are subject to a five percent (5%) customs duty, which is imposed at the time of delivery at the port or airport; there are no duties on the

import of personal effects. No customs duties are payable on goods that do not leave a free zone.

At the beginning of 2003, the G.C.C.'s Customs Union went into effect. Under the terms of this agreement, all six G.C.C. countries now apply the same tax rate of five percent (5%) to imports.

II. COMMERCIAL AGENCIES

Governing Law

U.A.E. commercial agencies are governed by the following laws: Federal Law No. 18 (1981), On the Organization of Commercial Agencies; Federal Law No. 14 (1988), the Agency Law; Federal Law No. 18 (1993), the Commercial Code; and Federal Law No. 5 (1985), the Civil Code. The Arabic word for agent, "wakil," is broadly defined to include any legal representation of a principal, thus rendering both the Civil Code and the Commercial Code applicable to legal issues regarding agency law.

Article 1 of the Agency Law defines a commercial agency as: "the representation of a principal by an agent for the purpose of distributing, selling, offering or providing merchandise or services inside the state for a commission or profit". A principal is defined as "the producer or manufacturer or the exclusive accredited exporter or representative of the producer".

The Agency Law makes no distinction between commercial agency agreements, and agreements regarding distributorships, franchises, commission arrangements and other forms of sales representative or sales agency relationships. All of these forms of business arrangements may qualify as commercial agencies under the Agency Law.

Marketing Goods and Services

Foreign businesses that desire to provide goods and services within the Emirates, but do not seek a physical presence there, usually conduct their business through the appointment of a U.A.E. commercial agent. Commercial agencies are attractive because there is relatively little cost or expense to a foreign company seeking to do business in the U.A.E. through this method, and, since business will be carried on through the name of the U.A.E. agent, there is no requirement to procure a separate business license on behalf of the agency.

Commercial Agency Requirements

In accordance with U.A.E. law, a registered commercial agent must either be a U.A.E. citizen, or a company that is 100% owned by U.A.E. citizens. The commercial agent facilitates the marketing of a foreign company's goods and services in one or more of the Emirates, as stipulated by an agency agreement between the foreign principal and the U.A.E. agent. The agency agreement also spells out all other rights and duties of the agent and principal, including the principal's profits and the agent's compensation—in the form of commissions—for his services within the U.A.E. The amount of the commission will vary depending on the type of business and will be payable only if

contracts for products or services are obtained. A registered commercial agency agreement is exclusive to at least one Emirate; the entire U.A.E. is normally covered in such an agreement.

Rights of A Registered Agent

The Agency Law requires that an agency agreement must be registered with the Ministry of Economy and Commerce. Once the agreement is registered, the Agency Law affords certain statutory protections to a local agent that cannot generally be circumvented—even if the agency agreement contains clauses contravening these protections. For example, a registered agent is entitled to commissions based on all sales the business makes within the specified territory, regardless of whether the agent actively participated in these sales.

Other protections afforded U.A.E. nationals by the Agency Law include the statutory right of an agent to prevent importation of goods subject to the agency where the agent is not the consignee of such goods. Imported goods subject to an agency agreement that are brought into the U.A.E. by persons other than the registered agent can be seized and held by U.A.E. Customs until either the agent or the Ministry of Industry and Commerce agrees to their release. In addition, in most cases, a principal must renew a registered agency agreement with the registered agent, even if the agreement provides for an expiry date.

Terminating a Registered Agency Agreement

Termination of a registered agency agreement by a foreign principal is very difficult, and a foreign principal generally needs the express permission of the U.A.E. agent to terminate the agreement regardless of whether the agency agreement provides for a fixed term. U.A.E. Agency Law does not allow the principal to terminate registered agencies without there being “justifiable cause”. U.A.E. courts have interpreted “justifiable cause” to include: (1) gross negligence; (2) impermissible dealing with competitive products / services; (3) assignment of the agency under a management agreement; (4) breaking the legal conditions relating to agent; for example where the agent is no longer an entity wholly-owned by U.A.E. nationals, and (5) failing to meet agreed sales targets. More often than not, the termination of registered agency agreements is completed through settlement agreements negotiated between the parties.

Unregistered Agency Agreements

Taking into account the potential risks with registered agency agreements, many foreign businesses enter into agency agreements with U.A.E. national agents without registering them with the Ministry of Economy and Commerce. Because unregistered agency agreements are not recognized as commercial agencies under the Agency Law, these agreements become subject to the U.A.E. Commercial Code and are treated as regular commercial contracts. This can give a foreign principal greater rights and flexibility and will allow a foreign principal to terminate such an agency agreement with a U.A.E. agent much more easily than a registered agency agreement.

III. COMMERCIAL COMPANIES: CHOICE OF ENTITY

U.A.E. law provides for a number of different legal entities through which foreign investors and groups can do business in the U.A.E. The common thread with regard to all of these entities is that one or more U.A.E. nationals must possess a minimum of 51% of the company's capital.

Governing Law

Commercial companies are governed by: Federal Law No. 8 (1984), On Commercial Companies; Federal Law No. 1 (1984); and Federal Law No. 13 (1988), the Commercial Companies Law ("CCL").

Article 5 of the U.A.E. CCL defines seven different types of entities that can be incorporated. For all intent and purpose, only five of these mentioned in Article 5 are available to foreign partners: (1) limited liability companies; (2) joint ventures; (3) public joint stock companies; (4) private joint stock companies; and (5) simple limited partnerships.

Branch and representative offices are other business vehicles available to foreigners that are subject to the CCL. In addition, free zone companies are becoming increasingly popular with foreign investors. Free zone companies are not governed by the CCL, but rather, by rules and regulations set out by the various free zones themselves.

A. *Limited Liability Companies*

A U.A.E. limited liability company ("LLC") is the preferred business vehicle for foreign investors seeking to establish a long-term presence in the U.A.E. The LLC remains attractive to foreign businessmen for its relatively low capital requirements, flexibility, and straightforward incorporation procedures. An LLC may engage in any business enterprise with the following exceptions: insurance, investments, and banking.

A minimum of two and a maximum of fifty persons may own an interest in an LLC. An LLC must have an initial share capital of no less than Dhs 150,000 (or Dhs 300,000 in Dubai), which must be fully paid up prior to incorporation, although the share capital of an LLC can be removed after incorporation. Individual shares must have an equal nominal value of no less than Dhs 1,000.

Under the CCL, a foreign company is permitted to become a shareholder in a U.A.E. LLC. However, U.A.E. citizens, or 100% U.A.E.-owned companies, must retain at least 51% of the shareholding of an LLC at all times. That being said, no U.A.E. law or regulation that requires the profit distribution to reflect the shareholding of the LLC, and the LLC's memorandum of association may stipulate a profit distribution different from that of the LLC's shareholding.

An LLC must obtain the appropriate authorizations before it can operate, including, among other things, the acquisition of a business license and registration of its memorandum of association with the U.A.E. Ministry of Economy and Commerce.

B. *Joint Ventures*

A joint venture (“JV”) is a contractual arrangement by two or more business partners who have come to terms on one or more business projects in the U.A.E. Foreign investors seeking to participate in specific projects within the U.A.E., or looking to do business in the U.A.E. on a short-term basis, often favor the JV option with U.A.E. partners.

Like an LLC, U.A.E. partners in a JV must have equity of at least 51%, although the profits can be distributed as prescribed by the JV agreement and do not have to be distributed in proportion to the shareholding. Business is conducted under the name of the local U.A.E. entity or citizen who holds the applicable business license. Unless the joint venture agreement is published with the applicable U.A.E. authorities, the local partners bear all liability on behalf of the JV.

Among the advantages of a JV are that it does not have to be independently licensed, nor does the joint venture agreement have to be published or registered with any of the U.A.E. ministries. In essence, the JV operates as an unregistered LLC, with greater flexibility to the partners. Potential disadvantages of the JV are that it cannot obtain financing independently, nor hire its own employees, but must perform these activities through the U.A.E. partners.

C. *Public Joint Stock Companies*

According to the CCL, a public joint stock company (“PJSC”) is a company whose capital is divided into common stock of equal value. Furthermore, while there are no limitations on the activities of a PJSC, it is the only type of U.A.E. company permitted to engage in insurance, banking, or investment of funds. Additionally, foreign investors seeking to incorporate a company with U.A.E. governmental entities must do so as a PJSC.

Shareholders are only liable to the extent of their shares in the company. The nominal value of the shares is to be no less than Dhs. 1 and no more than Dhs. 100. Minimum capital requirements are: Dhs. 10 million for a general company, Dhs. 25 million for an insurance or investment company, and Dhs. 40 million for a banking company.

A PJSC must have at least ten founding members and a board of directors of no less than three and no more than twelve members. At least ten percent (10%) of the net profits of a PJSC are to be allocated to a reserve account until this account is at least one half of the total paid-up company capital.

Because of the restrictions regarding their incorporation and the large capital requirement for their establishment, the costs of establishing a PJSC are prohibitive to all but the largest investors. However, a PJSC is the only type of legal entity where shares can be offered to the public.

D. *Private Joint Stock Companies*

Private joint stock companies are nearly identical to public joint stock companies in their incorporation procedures and in their operations. However, private joint stock companies differ from public joint stock companies in the following manners: (1) only three founding members are required; (2) the minimum capital requirement is Dhs. 2 million; and (3) the shares of a joint stock company cannot be publicly traded.

As a result of their lower capital requirement than public joint stock companies, private joint stock companies are an attractive option to a group of interested investors who seek to have a broad capital base with any shareholders.

E. *Partnerships/Limited Partnerships*

A general partnership is not a suitable business form for non-U.A.E. persons because all general partners in a CCL partnership must be U.A.E. nationals. Under the CCL, a simple limited partnership is a company formed by one or more general partners whose liability extends to all of the partnership's assets, and one or more limited partners, whose liability is restricted to their shares in the company. General partners must be U.A.E. nationals. Therefore, foreign partners can only be limited partners and are not permitted managerial roles in such partnerships, and foreign partners' liability is limited to their shares in the partnership. However, the limited nature of foreign participation allowed will detract most foreigner investors from opting for this business vehicle in the U.A.E.

F. *Representative and Branch Offices*

Representative offices are permitted for the limited purpose of marketing the goods and services of their foreign parent companies. A U.A.E. national or company seeking to enter into a contractual arrangement with the parent company would receive the assistance of the representative office in doing so, although the representative office would not be able to execute contracts in the U.A.E. As in the case of a branch office, representative offices are generally required to appoint a local services agent, or "sponsor".

Branch offices permit foreign businesses to establish a presence in the U.A.E. in an effort to generate particular commercial transactions with their parent companies. Under U.A.E. law, a branch of a foreign company does not have a legal identity separate from the parent company and is considered owned completely by the foreign company. While the costs associated with a branch office may attract certain foreign investors, the limitations imposed on branch offices may leave something to be desired for other foreign companies.

Once duly licensed and registered, a branch office may sponsor its own personnel for employment with the branch office, lease office space, and enter into contracts. However, a branch office may not import goods, equipment, or industrial plants. Such acquisitions would require the intervention of the branch office's sponsor, which a branch office (like a representative office) is required to appoint.

The sponsor must be a U.A.E. citizen, or a company 100% owned by U.A.E. citizens. The obligations of the sponsor are to obtain the appropriate licenses, visas, and other permits for the branch or representative office to operate. The sponsor is usually

not involved in the course of business of the branch or representative office. The sponsor is neither liable for any obligations of the branch nor representative office, nor is the sponsor required to invest any capital in such offices.

For the sponsor's services, the branch office pays the sponsor a fee expressed as a lump sum and/or percentage of profits or turnover of the branch office. The sponsor may seek and obtain additional fees for services provided beyond the basic registration and licensing requirements.

Sponsors, much like registered commercial agents, are difficult to terminate, even if a branch or representative office is not pleased with the performance of the sponsor's duties. If such offices attempt to fire a sponsor, he can lodge a complaint with the Chamber of Commerce of a particular Emirate, or the Ministry of Economy and Commerce. If this occurs, a branch or representative office would be unable to appoint a new sponsor until the dispute is completely resolved with the existing sponsor. Similar to registered commercial agencies, sponsorships are usually terminated with a settlement agreement between the parties, with the sponsor receiving a sizable monetary settlement.

G. *Free Zone Companies*

The newest type of business entities available to foreign investors are companies within the Free Zones ("FZs"). There are twenty (20) FZs in the U.A.E., including the JAFZ, the Dubai Airport FZ, the Hamriyah FZ in Sharjah and the Ras Al Khaimah FZ. The U.A.E. Companies Law is inapplicable to FZs; rather, FZs have their own separate, individual laws and regulations which govern their operations.

Establishing a business in an FZ - whether a new business or a branch office - is relatively straightforward. To qualify for a branch office registration, a company needs to have a valid registration in the U.A.E. or overseas, and shall submit a description of intended business activities within the FZ. Alternatively, a new company can easily be established under the laws of the particular FZ. Unlike all the other entities described above, there is no legal requirement to have a local partner. The initial capital deposit requirements for establishing a new FZ company can be substantial - US\$100,000 and above - but the capital can be withdrawn immediately after formation. There are no minimum capital deposit requirements for branch offices within FZs, because the mother company remains fully liable for all debts and obligations of the FZ branch.

Since a foreign investor will only have to deal with one entity for all applicable licensing and registration and visa issuance procedures—the particular FZ authority—incorporating in an FZ often proves to be easier and more cost effective than incorporating a regular commercial company. FZs provide the foreign investor with fully serviced office space, and the square meterage/footage of the space dictates the number of residency visas allotted to the company.

There are many advantages to incorporating within an FZ, including 100% foreign ownership, the right to have a single director and shareholder in certain FZs, and the inapplicability of U.A.E. laws requiring the appointment of an agent or a sponsor. Furthermore, an FZ company's employees are permitted to live and travel anywhere within the U.A.E., which can foster business growth within the FZ.

On the downside, FZs can have higher office rental fees that what may be found outside the zone, as the tenant/investor may be able to locate space at cheaper rates in less desirable areas. In addition, companies are not allowed to directly conduct business operations outside of their particular FZ, nor are they allowed to open branch offices or other ventures outside of the FZ. Goods imported into one FZ will be subject to custom duties once taken from the FZ into the rest of the U.A.E. However, recent emphasis in FZs attracting services companies (as opposed to consumer goods) has broadened the traditional tolerance of FZ company activities, and companies often provide a wide array of services to target consumers in the U.A.E. without fear of reprisal from governmental authorities.

CONCLUDING COMMENTS

Companies doing business in or seeking to establish their brand in the U.A.E. have the benefit of a wide array of legal structures to consider in developing the optimal market entry plan. Given the rapidly changing legal landscape, it is advisable to consult with local law offices in the U.A.E. before selecting one business structure over another.

The U.A.E. is a dynamic and exciting place to do business. U.S., G.C.C., European, Asian and other companies have unique access to capital, industrial and emerging and developed markets as well as exceptional tax and business incentives for locating in or relocating to the U.A.E.

If your company is going international, the U.A.E. is the place to be.

If you are interested in discussing in greater detail the legal and business issues impacting foreign investment and commercial opportunities in the U.A.E., please contact:

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