

HFW



UAE CORPORATE AND COMMERCIAL BITESIZE BULLETIN ISSUE 1 – SEPTEMBER 2020



Marhaba and welcome back from your summer!

We are delighted to introduce the HFW UAE Corporate and Commercial Bitesize Bulletin. Over the next few weeks we will be issuing updates covering a quick snapshot of legislative changes in the UAE over recent months.

In this first issue we will be covering recent corporate and commercial updates.

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Corporate and Commercial

- Economic Substance Regulations – what's next?
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- Scope of commercial agency arrangements expanded in the Commercial Agency Law
- New Offshore Companies Regulations issued in the Jebel Ali Free Zone

Economic Substance Regulations – what’s next?

The UAE Economic Substance Regulations issued under Cabinet Decision No. 31 of 2019 have recently been repealed and replaced by Cabinet Decision No. 57 of 2020 which came into force on 10 August 2020 (the New Regulations). Ministerial Decision No. 100 of 2020 was issued by the Ministry of Finance on 19 August 2020 which sets out guidance and direction for entities carrying out Relevant Activities in order to ensure compliance with the New Regulations.

Under the New Regulations, any entity that meets the definition of a “Licensee” that: (i) carries out a “Relevant Activity” and (ii) derives “Relevant Income” from a “Relevant Activity” during a “Financial Year”, is required to meet the “Economic Substance Test”.

A Licensee includes any legal entity established inside or outside the UAE, as well as any unincorporated consortiums with no separate legal personality that are licensed and registered in the UAE (including any free zones), and which carry out a Relevant Activity. There are certain forms of Licensees that are exempt from the requirement of meeting the Economic Substance Test (**Exempted Licensees**). These include: (i) Investment Funds; (ii) entities that are tax resident in a jurisdiction other than the UAE; (iii) entities that are wholly owned by UAE residents which meet certain requirements; and (iv) branches of foreign entities in which the income generated from a Relevant Activity is subject to taxation in another jurisdiction.

The definition of “Relevant Activity” in the New Regulations has not been amended and remains as follows: banking business, insurance business, investment fund management business, lease-finance business, headquarters business, shipping business, holding company business, intellectual property business and distribution and service centre business.

The Economic Substance Test requires a Licensee to demonstrate the following:

- the Licensee must conduct a “Core Income Generating Activity” in the UAE;
- the Relevant Activity must be directed and managed in the UAE; and

- the substance of the Relevant Activity being conducted in the UAE, for example, number of full time, qualified employees that are physically present in the UAE, sufficient operational expenditure in the UAE, and sufficient tangible assets in the UAE.

Within 6 months of the end of each Financial Year commencing after 1 January 2019, every Licensee and Exempted Licensee is required to submit a Notification to their respective Regulatory Authority setting out the following for each Relevant Activity for the relevant Financial Year:

- the nature of the Relevant Activity being carried out;
- whether it generates Relevant Income from that Relevant Activity;
- the date of the end of its Financial Year;
- any other information as may be requested by the Regulatory Authority.

The Relevant Authority to which the Notification is to be made is determined by the Relevant Activity that is being reported on, and is set out in Article 4 of the New Regulations. The Notification must be submitted electronically on the Ministry of Finance Portal. Licensees that have already submitted a Notification directly to their Regulatory Authority under the previous regulations are required to re-submit a Notification in accordance with the provisions of the New Regulations on the Ministry of Finance Portal once available.

Every Licensee that is required to meet the Economic Substance Test requirements must submit an Economic Substance Report containing the requisite information and documentation prescribed under the New Regulations within 12 months from the end of each Financial Year commencing after 1 January 2019.

A Licensee is not required to meet the Economic Substance Test (and file an Economic Substance Report) in a Financial Year in which it has no Relevant Income. However, the Licensee remains subject to the Notification requirement.

The New Regulations provide for the imposition of the following fines:

- AED20,000 for failure to submit the Notification;
- AED50,000 for failure to submit the Economic Substance Report, and

a fine of AED400,000 for a repeat violation; and

- AED50,000 for providing inaccurate information.

Registered entities in the UAE should assess their status and filing obligations under the New Regulations – whether they fall under the definition of a “Licensee” or “Exempt Licensee” and whether they have earned income from one or more “Relevant Activities” during the financial year which commenced on or after 1 January 2019. If the business activities of the entity are caught by the New Regulations, consideration needs to be given to compliance with the notification and reporting procedures and whether they meet the requirements of the Economic Substance Test, in particular for those entities which are due to submit an Economic Substance Report by 31 December 2020. Where an entity assesses that it has insufficient economic substance, consideration should be given to how it can be improved in order to meet the requirements of the New Regulations.

Recent developments under the Foreign Direct Investment Law

In an effort to increase foreign direct investment, in September 2018, the UAE Cabinet issued the Foreign Direct Investment Law (Federal Decree-Law No. 19 of 2018) (the FDI Law) which established the framework within which up to 100% foreign ownership of onshore limited liability companies (outside of the designated free zones in the UAE) may be allowed.

Historically, foreign entities or individuals could only own up to a maximum of 49% of the shares in an onshore company, with the remaining 51% owned by a UAE national or company wholly owned by UAE nationals. The FDI Law also established the Foreign Direct Investment Committee (**FDI Committee**) which is responsible for proposing FDI policies in the UAE and the Foreign Direct Investment Unit (**FDI Unit**) as the administrative arm of the FDI Committee.

The FDI Law contains a “Negative List” which is a list of economic activities where foreign ownership will continue to be restricted. Following unofficial publication in July 2019, the “Positive List” was officially issued under Cabinet Resolution No. 16 of 2020 in

March 2020. The Resolution also sets out the requirements for establishing 100% foreign owned companies in the UAE. The Positive List specifies 122 economic activities across 13 sectors in which 100% foreign ownership may be allowed. The relevant sectors are: administrative services; agriculture; art and entertainment; construction; educational services; healthcare services; hospitality and food services; information and communication; manufacturing; professional, scientific and technical activities; renewable energy; space and transport and storage.

At the time that the FDI Law was issued, the UAE Cabinet confirmed that it would be left to the discretion of each Emirate to consider and approve the establishment of a company under the FDI Law and, in particular, to decide on the percentage of foreign ownership for each sector/activity on the Positive List according to their individual circumstances. As such, what may be allowed will differ from Emirate to Emirate and a substantive application will have to be made to the relevant authorities substantiating a case for more than 49% foreign ownership and in particular satisfying any minimum capital requirements and Emiratisation thresholds set by the relevant authority. Applications to establish 100% foreign owned companies undertaking one or more of the activities on the Positive List are now being accepted by the Dubai Department of Economic Development and the Ras Al Khaimah Economic Zone where they are reviewed by an FDI committee on a case-by-case basis. While the Abu Dhabi Department of Economic Development did initially accept a few applications, we are advised that it has recently suspended its consideration of further applications until further notice. Where an application meets all the conditions and procedures set out in the FDI Law, subject to approval by the relevant FDI committee, a foreign investor will be able to incorporate a new 100% foreign owned company or convert an existing onshore limited liability company to a 100% foreign owned company. A number of 100% foreign owned companies have been established since the Positive List was unofficially published in July 2019. In some cases, the relevant authorities have imposed specific requirements on the shareholders as conditions to the establishment of the company. These conditions appear to be considered on a case-by-case basis and

are dependent on the nature of the activities of the company in question.

Scope of commercial agency arrangements expanded in the Commercial Agency Law

Further to the announcement made by the UAE Cabinet General Secretariat in January 2020, the Commercial Agency Law (Federal Law No. 18 of 1981) has been amended for the first time since 2010 by Federal Law No. 11 of 2020.

The key changes are:

- An amendment to Article 2 which expands the definition of which persons qualify for registration as a commercial agent in the UAE. Previously only UAE nationals or companies which were wholly owned by UAE nationals could register as commercial agents and benefit from the statutory protections granted under the Commercial Agencies Law. However, under the amendments introduced by Federal Law No. 11 of 2020, a public joint stock company (PJSC) that is owned at least 51% by UAE nationals or a private entity owned by such a PJSC is now also eligible to register as a commercial agent. This allows a UAE family business to now seek external foreign investment without losing its ability to register as a commercial agent. The Ministry of Economy is expected to issue a resolution on the procedures and controls necessary for the engagement and operation of PJSCs or private companies owned by PJSCs which are now eligible to register as commercial agents.
- A new provision at Article 8(3) which expressly states that the expiry of a contract term does not constitute a fundamental reason for termination of a registered commercial agency agreement. Termination or non-renewal of a registered commercial agency agreement is only permitted where there is a "fundamental" reason for termination or non-renewal and it has long been considered the case that expiry of an agreed contract term would not amount to a "fundamental" reason. In practice this means that it is very difficult for a principal to terminate a registered commercial agency agreement in the absence of a clear breach by the agent (for example, failing to meet the performance targets in the agreement) and that, notwithstanding any clause to the contrary, a registered

commercial agency agreement will generally automatically renew upon expiry of any agreed term.

- A new provision at Article 8(1) which expressly states that the heirs of an agent will inherit a registered commercial agency arrangement. Again this means that a registered commercial agency arrangement will not automatically terminate upon the death of an agent.

The amendments to the Commercial Agency Law came into force on 1 June 2020.

New Offshore Companies Regulations issued in the Jebel Ali Free Zone

The Jebel Ali Free Zone Authority (JAFZA) issued the JAFZA Offshore Companies Regulations in 2018 (the 2018 Regulations) on 1 January 2018, repealing the previous 2003 Regulations. Despite being issued in 2018, JAFZA only began to accept applications under the 2018 Regulations earlier this year. Accordingly, for clarity purposes, JAFZA are expected to confirm the enforcement date of the regulations soon.

The 2018 Regulations introduce several attractive provisions for foreign investors, namely:

- Offshore Companies can now own property and/or hold a lease of property for use as its registered office in any of the designated freehold areas;
- Offshore Companies may own a stake in another UAE company;
- members of Offshore Companies may apply for UAE residency if the Offshore Company owns property in any of the designated freehold areas, subject to authority approval;
- Offshore Companies may re-domicile into another foreign jurisdiction;
- Offshore Companies may convert into a JAFZA registered company;
- Business affairs of Offshore Companies can be managed by one director; and
- Offshore Companies may apply to have different classes of shares.

We hope you have enjoyed reading our update. If you have any questions, please do not hesitate to contact the authors of this article



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