UAE

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

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1. INTRODUCTION

This guide provides an overview of the law and practice dealing with private M&A transactions in the United Arab Emirates (UAE). This guide does not constitute legal advice. Anyone involved in private M&A transactions should seek specialist advice.

2. BRIEF NOTE ON THE UAE

The UAE is a federation comprised of seven emirates formed on 2 December 1971 following the end of the British protectorate over what was recognised as the 'Trucial States'. The seven emirates which now form the UAE include Abu Dhabi, Ajman, Dubai, Fujairah, Sharjah, Umm Al Qaiwain and Ras Al Khaimah.

The UAE currency is the UAE dirham (AED); its exchange rate has been pegged to the US dollar since 1997 at approximately 3.67 per US dollar. The UAE currently has no currency import or export controls.

In the years 2021 and 2022, M&A activity appears to have made strides toward recovery following the onset and subsequent impacts of the Covid-19 pandemic. In a broader sense, the Middle East region recorded strong M&A activity in 2021 with increases in the volume of transactions compared to numbers recorded in 2020.

The resilience of the UAE's infrastructure and the strong policy response to the Covid-19 pandemic has allowed for a strong rebound in businesses in the region, which has also helped reinforce confidence for investors both in the region and abroad. The UAE has historically been characterised as a seller-friendly M&A market in terms of risk allocation. While this characterisation is still attributed to the UAE, the UAE continues to expand the regulations regarding disclosure and transparency protections for potential buyers in the UAE.

3. THE UAE LEGAL FRAMEWORK

3.1 General legal framework

The UAE Federal Constitution divides powers between the federal government, which is stationed out of Abu Dhabi, and the governments in each of the constituent emirates. Certain industries and areas of law fall under the purview of the federal government (eg, labour relations, immigration and taxation) while others are regulated at the emirate level (eg, each of the seven emirates retains sovereignty over its own natural resources, including crude oil and natural gas reserves). Even at the federal level, local interpretations, customs and practices may vary from one emirate to another. Additionally, there are certain matters which are regulated through a hybrid model, including regulation by the federal government with interpretation and application by each of the individual emirates (eg, company formation, registration, and healthcare).

Businesses operating anywhere in the UAE must hold a licence which authorises the specific business activities carried out by the company. Licences are issued by the concerned authorities in each emirate and are generally only valid in one emirate (eg, if operating in Dubai and Abu Dhabi, an individual licence would be required in each emirate).

In addition to the licensing rules which are imposed in each emirate, a separate layer of federal regulation also applies to businesses operating in the UAE. Companies incorporated in the UAE (outside free zones) that are involved in activities or sectors which are classified by the law as having a 'strategic impact' must be at least majority owned (51 percent) by a UAE national or wholly Gulf Cooperation Council (GCC)-owned.

Historically, the UAE has been recognised as a zero-tax jurisdiction. However, VAT was introduced in 2018 at a rate of 5 per cent. More recently, in the early months of 2022, the UAE announced the introduction of a corporate tax, which will commence from June 2023. The UAE corporate tax is a federal tax and will therefore apply across all emirates, with the Federal Tax Authority (FTA) responsible for administration and compliance of the UAE corporate tax regime.

The corporate tax rates to be levied are as follows:

a) 0 per cent for taxable income up to AED 375,000; and
b) 9 percent for taxable income above AED 375,000.

While many details pertaining to the UAE corporate tax regime remain unknown at this time, the introduction of corporate tax in the UAE will add a new layer of operational and legal considerations for M&A structuring and activities in the UAE.

3.2 M&A legislation in the UAE

The key federal laws which govern M&A activity in the UAE include:

a) Federal Decree-Law 32 of 2021 on Commercial Companies (CCL), which sets out restrictions on share transfers and foreign ownership, and outlines the statutory merger regime;
b) Federal Decree-Law 19 of 2018 on Foreign Direct Investment (FDI Law) and Cabinet Resolution 16 of 2020 Regarding Determining the Positive List (FDI Implementing Regulations), which regulates foreign investment in accordance with the policies of the UAE; and
c) Federal Law 4 of 2012 on the Regulation of Competition (Competition Law), which identifies anticompetitive practices such as abuse of a dominant position.

Additional provisions are also applied from:

a) Federal Decree-Law 33 of 2021 on the Regulation of Labour Relations (Labour Law), which regulates the transfer of employees upon the sale of a business;
b) Federal Law 7 of 1999 concerning Pensions and Social Securities (as amended) (Pension Law), which must be considered in any transfer of a business where a company employs UAE or GCC nationals; and
c) Federal Decree-Law 8 of 2017 on VAT (VAT Law), insofar as tax advice must be sought in each case to assess whether VAT may be applicable in the context of a particular transaction.

In addition to the key federal M&A laws, there are supplementary laws, regulations and cabinet resolutions which must also be considered in respect of M&A transactions in the UAE, including:

a) Securities and Commodities Authorities (SCA) Disclosure and Transparency Regulations 2000 (as well as all further amendments and resolutions);
b) Regulations for Trading, Clearing, Settlement, Transfer of Ownership and Safekeeping of Securities (SCA Board of Directors' Resolution 2 of 2001);

c) SCA Administrative Resolution (62/RT) of 2017 Concerning the Technical Requirements for Acquisitions and Merger Rules;
d) Rules of Acquisition and Mergers of Public Joint Stock Companies (Resolution of the Chairman of the SCA Board of Directors (18/RM) of 2017);
e) Cabinet Resolution 13 of 2016 Concerning Application of the Competition Law; and
f) Cabinet Resolution 22 of 2016 in respect of Small and Medium-size Enterprises.

3.3 UAE free zones

A notable feature of the UAE landscape are the designated free zones across the emirates. There are several free zones operating in the UAE, with each free zone designed around one or more commercial category. Historically, the main attraction for UAE free zones was the feature of 100 per cent foreign ownership, which was not available for companies incorporated in onshore UAE. Following the recent amendments to the CCL, including removal of the restriction to foreign ownership under Article 10, companies incorporated onshore UAE no longer require 51 per cent ownership by a UAE national (with some exceptions as outlined above for sectors with 'strategic impact').

While the UAE corporate tax law is not yet applicable, the understanding is that it will not apply to companies incorporated within those free zones that provide tax exemptions. As such, companies looking to avoid the UAE corporate tax may wish to incorporate in one of such free zones.

While the level of sophistication around laws and operations tend to vary between the free zones, each free zone authority has autonomy over the licensing requirements and the regulations applicable to companies incorporated within their jurisdiction. A business that wishes to operate in a free zone must obtain a licence from that free zone authority. Free zone licenses authorise the conduct of the licensed activity within the geographical limits of the free zone only, and do not extend to onshore UAE.

In respect of companies operating in a UAE free zone, the separate legal framework of the free zone will apply. Where a free zone company undertakes an activity outside the legal remit of the relevant free zone, the UAE laws, rules and regulations would then apply, regardless of the fact that the company is based in the free zone. Federal laws will also apply to free zone companies in the event that the relevant free zone authority has not implemented its own laws on the matter.

3.4 Government regulators and agencies

M&A activity within the UAE generally falls under the purview of the following regulatory bodies:

- Securities & Commodities Authority for listed entities (SCA);
- Competition Regulation Committee of the UAE Ministry of Economy;
- UAE Central Bank for banks and licensed financial companies; and
- Department of Economic Development in each of the emirates.

4. TRANSACTION STRUCTURES IN THE UAE

In the UAE, there are generally two principal methods for structuring a private M&A transaction. The first method is to structure the transaction as a share deal (share sale). In a share sale, the buyer acquires the share capital of the target company (target) and ultimately acquires ownership of the target along with all its assets and liabilities. Share sales are the most common M&A transactions in the UAE.

The second method is an asset sale (asset sale). Asset sales became increasingly common in the UAE during the course of the Covid-19 pandemic. Under an asset sale, the buyer would acquire the assets and liabilities of the target (potentially selecting only certain assets and liabilities which they deem desirable). Asset sales can be an attractive option for an incoming buyer as it allows the buyer to tailor the transaction with the assets and liabilities they want, while excluding any assets or liabilities they wish to leave out.

4.1 Documents required for UAE M&A transactions

4.1.1 For a share sale

For a transaction involving a share sale, as is the case in many jurisdictions, a share purchase agreement (SPA) will be required. The UAE does not set onerous requirements for the SPA. The SPA can be drafted as a long-form or short-form document detailing the terms and conditions of the transaction. This will be the main transactional document in a share sale.

The SPA can be drafted in English and does not need to be notarised by a notary public to be enforceable. The SPA can be governed by UAE law or foreign law; it is generally acceptable for SPAs to be signed via an electronic format provided that the signatory meets certain requirements with respect to verification. Similarly, for licensing requirements, the process and documentary requirements for a share sale will vary based on where the target is incorporated. A disclosure letter should also be provided by the legal team on behalf of the sellers detailing the general and specific disclosures regarding the seller's warranties in the SPA.

In order to implement the transfer of shares in an onshore limited liability company (LLC), a separate short-form share transfer instrument will also be required. The share transfer instrument will need to be in Arabic or a bilingual format including Arabic. If the share transfer instrument is drafted in bilingual format (eg, Arabic and English), the document will need to be stamped and attested by a certified translator in the UAE and will then need to be signed by each of the parties to the transaction, including the existing shareholder and the new shareholder. As the UAE is a civil law jurisdiction, the share transfer instrument will need to be signed in front of a notary public in the jurisdiction where the target is incorporated. As a response to the Covid-19 pandemic, and now more generally as a measure of convenience, the UAE has introduced the option to execute various forms of legal documents via a video conference with the notary public.

To execute the share transfer, an amendment to the target's memorandum of association (MOA) will also be required to evidence the new company shareholders. The amendment to the MOA (which needs to be drafted either in Arabic or bilingual with Arabic), will also need to be signed before the notary public in the emirate where the target is incorporated. Where any of the shareholders is a corporate shareholder, authorisation by way of a board or shareholders' resolution will also be required as well as a power of attorney authorising the signatories in the transaction. If the buyer is a foreign entity, its constitutional documents will be required, and these will need to be legalised up to the level of the UAE Embassy in the country of incorporation of the buyer. The constitutional documents will then need to be translated into Arabic by a UAE certified translator and stamped by the Ministry of Foreign Affairs (MOFA) in the UAE.

Together, these will constitute the key M&A documents required in a share sale; however, there may be additional documents required depending on the nature of the transaction. As an example, a shareholders' agreement may be required, or a transitional services agreement or employment agreements for key employees.

4.1.2 For an asset sale

The key transactional document in an asset sale is the asset purchase agreement (APA). The APA details the terms and conditions of the sale. The APA does not need to be submitted to a notary or presented before any authorities in the UAE. As the APA will not be presented to any UAE authorities, the parties may select any language for the APA which they deem appropriate and there are no restrictions which prevent the APA from being signed electronically where the parties agree to this.

Where the assets being purchased in the asset sale are registered assets, the parties will generally execute a short-form asset purchase instrument (API) for the purposes of filing with the authorities. Moreover, for certain assets, separate agreements may also be required such as customer and supplier contracts, employee's agreements or real estate contracts.

4.2 Tax considerations for M&A structures

Historically the UAE was a tax-free jurisdiction. However, in 2017, the UAE issued a substantive law on VAT, the VAT Law. Pursuant to the VAT Law, the imposition of VAT in the UAE commenced on 1 January 2018 at a rate of 5 per cent. Registration for VAT is mandatory for any taxable person or business if the total value of its taxable supplies made within the UAE exceeds the mandatory registration threshold of AED 375,000 during the previous 12 months, or if it is anticipated that the taxable supplies will exceed the aforementioned threshold within the upcoming 30 days. VAT may be applicable on certain aspects of M&A transactions and applicability of VAT should be considered at the outset of the transaction.

In terms of tax considerations for a share sale, there are generally no transfer taxes applicable on transfers of shares. Article 7(2) of the VAT Law provides that the transfer of the whole or an independent part of a business from a person to a taxable person for the purposes of continuing the business that was transferred shall not be considered a supply for VAT purposes. A company can be bought and sold by the transfer of shares. The company itself is not involved in the transaction and therefore the transfer of shares does not affect the business's operations, as all assets, liabilities, licences and relationships are retained. The buyer takes over the business with all of its assets and liabilities, including its existing tax obligations.

With respect to tax considerations for an asset sale, the transfer of assets involves the transfer of title in the assets from one person to another. In this type of sale, the ownership of the company remains the same and the buyer does not take on liabilities (including tax liabilities) that have not been party of the transaction or attached to the assets that have been purchased. The sale or transfer of assets by a taxable person or business is typically treated as a taxable supply and therefore subject to VAT at the appropriate rate. However, there are exceptions where the supply of specific assets is exempt from VAT, such as in the sale of bare land or residential property. Additionally, where assets are sold as part of a transfer of a business as a going concern (TOGC), the transfer is not considered a supply, and therefore no VAT is charged. This treatment applies irrespective of the VAT treatment that would apply if the assets were sold individually.

For a transfer to be treated as a TOGC, the following conditions shall be applicable (at the time of the transfer):

a) There must be a transfer of the whole (or an independent part) of a business. The transfer must give the buyer possession of the whole business or part of the business which can be operational exclusively from the main business. All the goods and services necessary for the continued operation of the business (or the relevant part) must be supplied to the buyer. This would include for example, licences, employees and commercial contracts.
b) The buyer must be a taxable person, meaning either (1) the recipient is registered for VAT, (2) the recipient is required to be registered, and has applied to be registered with the FTA; or (3) the recipient has applied (and the FTA has accepted) for a voluntary VAT registration.
c) The buyer must have a genuine intention to carry on the same kind of business to that which it is acquiring.

In addition to the VAT tax consideration, the recent announcement of UAE corporate tax will likely have significant implications for M&A structuring in future years.

4.3 Compliance considerations for sale shares versus asset sales

The compliance considerations are generally the same for an asset sale and a share sale. However, depending on the nature of the assets involved in an asset sale (such as registered assets, cars or real estate), there may be certain additional steps required to transfer and register title to such assets.

There may also be additional fees which vary between an asset sale or a share sale, such as transfer fees payable with respect to real estate, processing fees applicable for signing share transfer documents before relevant authorities, and applicable administrative fees.

In cases where the target either owns real estate assets or was granted rights over real estate assets, any transfer in the ownership of shares in the target is deemed to constitute a transfer of the real estate interest, whether the target is located within the UAE mainland or a free zone. Accordingly, transfer fees may be payable to the relevant land department. In the Emirate of Dubai, the current transfer fee applicable for the transfer of ownership is approximately 4 per cent of the higher of either consideration of the sale, or market price. This transfer fee is typically paid by the buyer however it can be paid by either the seller or the buyer.

4.4 Pre-agreement documentation

It is customary for parties to a transaction to prepare a memorandum of understanding, sometimes also referred to as a letter of intent or a term sheet (MOU). The MOU typically sets out the commercial terms of the transaction in a brief and succinct document. The MOU is generally a non-binding agreement and will include standard terms (intended to be binding) such as the costs, timelines, exclusivity, confidentiality, and governing law.

4.5 Due diligence stage

Similar to most jurisdictions, a due diligence investigation in the UAE is typically completed prior to the execution of the SPA or the APA. The scope, quality and size of the due diligence investigation will vary widely based on the nature of the transaction and the parties involved. Factors such as the activity and industry of the target, as well as the risk appetite of the buyer and their familiarity with the region, may also impact the scope of the due diligence investigation.

While there are several issues which are generally reviewed in the course of a due diligence investigation and the pressure points in any given transaction will depend on certain factors, it is particularly relevant when carrying out due diligence investigations in the UAE to verify the ownership of the target (especially where the target is an older UAE company).

One of the most frequent due diligence issues that a foreign investor should be aware of in the UAE relates to foreign ownership restrictions under UAE laws. Also relevant are requirements with respect to licensing, employment, litigation and compliance. The CCL recently removed many statutory local ownership requirements. However, because these changes are quite recent, many existing companies continue to have a 51 percent UAE national owner (local partner). Where the company has not taken active steps to remove the local partner (via a share transfer or share purchase), the local partner will still be the legal owner of 51 percent of the company. Review of the company licence and the memorandum of association (including amendments) should confirm who the current partners are for onshore companies in the UAE. Many foreign companies also have contractual service providers knows as local sponsors (local sponsor). Identifying the presence of a local partner or local sponsor will be key in any due diligence investigations, as the involvement of such a party can lead to delays and expenses in completion of the transaction and transfer of ownership.

Company searches are generally not available for onshore UAE companies. Only the relevant company (or an individual authorised by a power of attorney given by that company) may request and obtain a copy of the trade licence and commercial registration certificate. As such, verification of the ownership structure through the due diligence process depends on disclosure by the target of all relevant documentation and information.

Employment is another key factor to consider during the due diligence process. Pursuant to the Labour Law in the UAE, employees are entitled to certain end-of-service benefits and payments, calculated on the basis of their annual salary and their years of service. This may need to be addressed under the SPA and reflected in the purchase price as a possible liability. Moreover, there are instances where key employees of the target may not be technically employed by the target, but rather they perform certain employment functions in relation to the business of the target. During the due diligence process, these types of arrangements should be flagged and should be considered prior to completion of the transaction as the employees may have significant impact on client relations and operations of the target.

5. MAIN TRANSACTION AGREEMENT

5.1 Formal requirements

The central document for any M&A transaction is the main purchase agreement (or merger agreement depending on the nature of the transaction). To execute the transaction for onshore UAE, the purchase agreement will need to be in Arabic (or bilingual with Arabic and English) and it will also need to be notarised with the notary public in the relevant emirate.

Historically, issues have arisen with respect to notarising complex long-form agreements as the notary public is reluctant to review and notarise these documents. To circumvent this issue, it is standard practice in the UAE to have two purchase agreements:

a) The main agreement is the long-form purchase agreement that sets out the extensive terms, conditions and warranties of the transaction. This long-form agreement will be signed by the parties and does not need to be notarised.

b) In addition, the parties will also prepare a second short-form agreement which will detail the transaction in much simpler terms. This document will be signed before a notary public.

5.2 Key clauses in UAE M&A transaction documents

While the specific provisions to include in the share sale SPA will vary depending on the nature of the transaction, the standard key clauses would typically include:

a) the terms of the sale and purchase of the shares (eg, the particulars of the company, the current and new shareholders, and the number of shares being purchased);
b) the consideration for the shares being purchased as well as any adjustments to the consideration (as applicable);
c) applicable conditions to the transaction whether conditions precedent (eg, prior to completion of the transaction) and conditions subsequent (eg, conditions on the parties following the purchase of the shares);
d) mechanisms for closing and completion of deliverables in the purchase agreement;
e) pre-completion undertakings;
f) provisions relating to leakage (as applicable);
g) warranties and indemnities;
h) confidentiality and restrictive covenants;
i) governing law and jurisdiction;
j) provisions with respect to VAT;
k) data protection provisions (depending on the nature of the parties); and
l) additional standard provisions such as notices, variation, assignment, mechanisms for signature and counterpart.

Many of the key provisions above also would be applicable for an asset sale APA, with the exception of the sale and purchase provisions. These would be replaced with the details regarding the specific assets and liabilities being purchased and (as necessary) would carve out certain assets or liabilities. In the case of an asset sale, additional provisions may be required to outline the mechanisms for transferring title (applicable for certain assets) to the buyer and how this process shall be treated by the parties.

In addition to the provisions outlined above, an APA may include the following:

a) provisions addressing transfer of title and risk allocation for the assets (eg, who assumes risk during the delivery of the asset);
b) schedules setting out the assets that are subject to the transfer;
c) responsibility for collection of debts of the business; and
d) apportionments for the period before and after completion.

Warranties and indemnities are typically included in acquisition agreements, with the scope of warranties negotiated between the parties. It is common to see warranties relating to the accuracy and validity of information and documents relating to the target, such as:

a) corporate information and licences;
b) accounts and finances;
c) records of the business;
d) compliance (past and present) with the law, including international sanctions and anti-money laundering;
e) tax registration and liabilities;

f) environmental factors;
g) material contracts;
h) insurance;
i) intellectual property and information technology; and
j) Title to the shares or assets subject to the proposed transaction.

This is a non-exhaustive list and specific warranties may also be required based on the nature of the transaction and the parties.

5.3 Dispute resolution provisions

While the UAE generally allows parties the freedom to apply a foreign governing law, it is typical for the SPA to be subject to one of the following jurisdictions:

a) the UAE courts;
b) the Dubai International Financial Centre courts; or
c) the Abu Dhabi Global Market courts.

It can be challenging in the UAE to enforce a court order or arbitration award where the court order or arbitral award is granted in a jurisdiction other than the options listed above.

6. TYPICAL CONDITIONS TO CLOSING

It is common to see a split exchange and completion with M&A transactions in the UAE. Frequently, the conditions precedent include approvals and consents from relevant registration authorities such as a pre-approval from the Department of Economic Development (DED) where the target is an onshore company. Where the target is based in a free zone, similar consents or approvals may be sought from the relevant free zone authority.

Depending on the activity of the target and the industry it operates in, there may be a requirement for additional approvals from other UAE authorities (eg, where the target is licensed for certain healthcare activities, a notification may be required to send to the health department in the relevant emirate). In relation to commercial contracts, third-party consents may be desired where there are change of control provisions.

Parties may also need to consider whether a competition or merger filing is required with the Competition Regulation Committee of the UAE Ministry of Economy (MOE) under the Competition Law. A merger clearance filing may be required where the proposed merger, acquisition or consolidation of two or more entities would result in a market share of 40 per cent or more. The concerned market is broadly defined under the Competition Law to comprise of markets in which commodities or services are replaceable, or may be substituted to meet specific needs according to price, properties and use. The requirements for a merger clearance filing should be evaluated on a case-by-case basis and should be determined at the outset of any given transaction.

7. CLOSING ACTIONS

The completion mechanics include the procedural steps of finalising and executing the sale. Where there is a share sale, this requires the execution of the transactional documents outlined above (such as the long-form and short-form SPA) and the execution of the amendment to the MOA before the UAE notary public.

Shareholders of an onshore LLC have statutory rights of pre-emption on all transfers of shares in that LLC which would need to be waived by any remaining shareholders in order to effect the share transfer.

With an asset sale, there is no change in control and ownership of the company and therefore the only requirement is execution of the API in front of a notary public in the UAE. In either sale, subsequent steps will be required to register the transaction with the relevant authorities.

8. POST-CLOSING

In the case of a share sale, following the execution of the documents including the amendment to the MOA, the documents will need to be registered with the DED in the emirate where the target is incorporated. The DED will then update the commercial licence of the company and issue a new licence stating the names of the new shareholders with their respective shareholding.

If the buyer of shares is a corporate entity, the DED (similar to the notary public) will require the constitutional documents of the buyer to be submitted for review and verification, along with a corporate resolution resolving to acquire the shares and to appoint a signatory to sign the transaction documents for the share transfer. The same rules outlined above regarding foreign entities would be applicable (eg, attestation up to the level of the UAE Embassy, translation and MOFA stamping).

It is important to consider procedures with respect to employees of the target. In the UAE, all employees who are employed by the target remain employed by the target upon closing of the transfer of the shares. Accordingly, all employment contracts and immigration permissions also remain in place. In the event that certain employees of the target are not technically employed and rather perform certain employment functions in relation to the business, the process for transferring those employees would be similar to that of an asset sale.

In the event of an asset sale, unless the assets to be transferred are registered assets, there is no requirement to file any documentation with the relevant authorities. With respect to movable assets, these may be transferred between parties without concluding an APA. These can instead be executed through a purchase order. Where the asset sale does involve the transfer of registered assets, the API would need to be signed in front of a notary public and filed with the relevant authorities. Moreover, certain types of registered assets may include a separate registered transfer agreement to be entered into or a specific procedure to be followed. Assets such as real estate, employees, certain types of intellectual property and vehicles would involve registrations with the relevant authorities (eg, for real estate, the land department in the relevant emirate).

With respect to treatment of employees in an asset sale, there is currently no mechanism for transferring employees in the event of an asset sale. The general approach in the UAE would be to terminate the current employment with the seller and to rehire the employee. In this case, new employment agreements would need to be entered into between the buyer and the employee, and new residency visas would need to be obtained under the sponsorship of the buyer. There is no obligation on the buyer to replicate the terms of the employment conditions; in the event that the employee refuses to transfer employment under the buyer, the employee would remain employed by the seller unless otherwise terminated.