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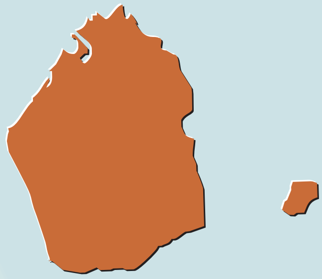

Tax planning in Dubai

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I. Introduction

A. Constitution and government

The United Arab Emirates (UAE) is a federation of seven Emirates established in 1971. Dubai is one of the seven emirates. The others are Abu Dhabi, Ajman, Fujairah, Ras Al Khaimah, Sharjah and Umm Al Quwain. The modern emirate of Dubai was created on the formation of the UAE, but written accounts document the existence of the city of Dubai for at least 150 years prior to the formation of the UAE. Dubai has the largest population (1.4m as at the last census in 2006), and has the second largest area size after Abu Dhabi.

The UAE federal system of government includes a Supreme Council of the Union (SCU), a Cabinet, or Council of Ministers, a parliamentary body, the Federal National Council, and an independent judiciary, at the apex of which is the Federal Supreme Court. The Federal National Council (FNC) is drawn from the emirates on the basis of their population. Half of the FNC members are chosen through a process of indirect elections. The federal governments has exclusive jurisdiction in foreign affairs as well as health and education. The UAE constitution apportions powers between the federal government (based in Abu Dhabi) and the governments of the constituent Emirates. The federal government is entrusted with the task of regulating the principal aspects of the federation. Each of the seven emirates also has its own local government. Individual emirates exercise exclusive jurisdiction in all other matters than those transferred to the federal government e.g. matters relating to municipal work and natural resources. In practice, most matters are now regulated at federal level (real estate matters being a significant exception to this), although local interpretations of federal regulations sometimes differ from one Emirate to another. In the event of a conflict between federal and local laws, the constitution provides that federal law will override the local law of the Emirate.

Dubai's government operates within a constitutional monarchy framework and the emirate has been ruled since 1833 by the Al Maktoum family. The current ruler of Dubai, Sheikh Mohammed bin Rashid Al Maktoum, is also the Prime Minister of the UAE and member of the SCU. Dubai appoints eight members in two-term periods to the FNC.

B. Economy

In recent years, the UAE has overall enjoyed rapid economic growth. In 2007 the economic growth amounted to 7.4 percent and the economy should expand by over seven percent this year. Over the past few years the strong economic growth of the UAE has been driven by high oil prices but also by the rapidly expanding non-oil sector, with the non-oil sectors accounting for 65 percent of the UAE gross domestic product in 2007.

Most of Dubai's revenues are from trade, manufacturing, financial services and tourism. Petroleum revenues currently contribute less than six percent of Dubai's US$40 billion plus economy.

Dubai has emerged as regional business hub, including services, trade, IT and finance; and attracted world-wide attention through innovative real estate projects and sports events. It is considered to be an important tourist destination and its port, Jebel Ali, has the largest man-made harbour in the world. Dubai has a strategic location and it serves as the biggest re-exporting centre in the Middle East. Its low logistical and operational costs and excellent infrastructure, international outlook and liberal government policies are attracting investors. However, robust economic growth in recent years has been accompanied by rising inflation rates (11.2 percent in 2007 when measured against the Consumer Price Index) attributed in part to near doubling of commercial and residential rental costs.

C. Setting up an office

Outside of the free zones (see section II.c. for free zones), every entity doing business in the United Arab Emirates, other than a contractual joint venture, is required to be entered in the Commercial Register of the emirate in which it is licensed and in the Commercial Companies Register at the Ministry of Economy and Commerce. In addition, the Articles of Association must be published in the Companies Bulletin issued by the Ministry of Economy and Commerce.

Rules and regulations for conducting business from Dubai are among the most liberal and attractive in the Middle East region, and companies seeking to establish a business presence in Dubai have a host of alternatives. To operate a company in Dubai, one has to obtain a relevant licence and there are broadly three forms of licenses: commercial licenses (covering all kinds of trading activities), industrial licences (industrial and manufacturing) and professional licenses (professionals, services, craftsmen, artisans). The licenses are issued by the Dubai Department of Economic Development, and some specific businesses require approval from other authorities (e.g. banks and financial institutions require approval from the Central Bank of the UAE). In general all industrial and commercial businesses in Dubai must be registered in the Dubai Chamber of Commerce and Industry.

D. Foreign investment

There are generally no foreign exchange restrictions, controls, quotas or trade barriers within the UAE. Businesses and individuals may freely remit equity capital, debt capital, dividends, branch profits, interests, royalties, management and technical service fees, and personal savings abroad.

There are however restrictions on the level of foreign ownership in UAE entities. Generally, UAE nationals must own a minimum of 51 percent of all public and private shareholding companies as well as limited liability companies. In addition, non-UAE nationals may not be general partners in partnerships. These restrictions do not apply to companies established in free zone establishments (which are discussed in detail later below). Also, proposals to increase the levels of permissible foreign ownership are currently being considered, and it is very likely that the restrictions would be reduced in the near future.

II. Business entities

A. Types of company forms available

The summary that follows covers the company forms available to businesses setting up outside the free zones.

The UAE Company Law regulates the activities and the registration of foreign companies intending to establish a presence in the UAE. This applies to foreign companies that practice their main activity in the UAE or have their headquarters therein as well as foreign companies that wish to establish a registered branch office.

Companies incorporated in the UAE may take one of the following forms:

- General partnership

General partnerships are formed by two or more UAE nationals who are jointly and severally liable for its debts. This form is generally not available to non-nationals. Only the names of actual partners can be included in the company name, but the company may have a special trade name.

Interests of a partner can be transferred as stipulated in the partnership agreement or with the approval of all partners. The management may include one or more managers who are UAE nationals and who may or may not be partners in the company. The dissolution of a partnership may occur on the death, insanity, bankruptcy or withdrawal of one of the partners. The remaining partners, however, may unanimously decide to continue the partnership, provided that such decision is registered in the commercial register.

- Simple limited partnership

A limited partnership is composed of one or more general partners who are jointly and severally liable for all of its debts, and one or more limited partners who are liable for the limited partnerships debts only to the extent of his capital contribution. A limited partner may not participate in the management or have his name appear in the name of the partnership. All general partners must be UAE nationals.

- Joint participation (venture)

A joint venture is formed by two or more natural or legal persons. They all have to be already legally registered in the UAE. The objectives and terms of the joint venture are governed by the joint venture contract.

- Public joint stock company

The PSC must have at least 10 founders, unless a government entity is involved, in which case the number of founders may be lower. A minimum of 55 percent of the shares of a public shareholding company must be offered to the general public. The minimum amount of capital for a public shareholding company is Dhs10 million, of which a minimum of 25 percent must be settled on subscription. A shareholder's liability is limited to the nominal value of his shares in the company's capital.

Shares are registered in a share register and cannot be issued at a price lower than nominal value; all shares have equal rights. The Board of Directors of this type of company must have a minimum of three and no more than twelve members. The chairman, as well as a majority of the board, must be a UAE national.

In the event that a public shareholding company loses half its capital, its board of directors is required to call a general meeting of shareholders to consider the continuation or dissolution of the company. If the board fails to call such meeting or if the meeting fails to reach a decision on the subject, any interested party may file a lawsuit seeking the dissolution of the company.

- Private joint stock company

A private shareholding company must have a minimum of three shareholders. The minimum capital of a private shareholding company is AED2 million. Shares may not be offered to the public. The private shareholding company's incorporating documents must preclude public offering of shares.

- Limited Liability Company (LLC)

A Limited Liability Company must have at least two but not more than 50 shareholders. The minimum capital required to establish a Limited Liability Company is Dhs300,000 in Dubai. Management has to be handled by no more than five designated managers, who are not necessarily members of the company. Non-UAE nationals may own up to 49 percent of an LLC.

The Companies Law provides that an LLC may engage in any lawful activity except insurance, banking and investment of money for others. The liability of each person is limited to their shares in the capital of the company.

- Branch office of a foreign company

A foreign company may establish a branch in the UAE but a local sponsor or agent is required who must either be a citizen of the UAE or a company wholly-owned by citizens of the UAE. A branch must be registered with the local chamber of commerce and the appropriate authority within the relevant emirate. Since February 1990, branches of foreign companies (including those already in existence) are also required to register with the Ministry of Economy and Commerce.

A branch office of a foreign company is not considered to have a separate legal entity. It merely represents the mother company and carries out business under its name. A branch office is usually permitted to promote and to market the products of its parent and enter into transactions and offer service to customers in its name. Branches of foreign companies may be 100 percent foreign owned provided a UAE agent (or local service agent) is appointed. Local service agents would have no equity stake in the company and would not have any management power. They would also not be responsible for any of the financial obligations of the branch, and their services consist mainly in obtaining the relevant licences and authorisations. Agents are paid a lump sum and/or a percentage of profits or turnover.

B. Special categories of companies

As indicated, a licence must be obtained from Dubai's Department of Economic Development prior to commencing commercial activities. Certain sectors (such as banking and financial institutions, education, industrial projects, sea cargo, freight forwarding and cargo clearing) are required to obtain additional approval from the supervising government departments.

As also previously indicated, foreign ownership of a UAE company is currently capped at 49 percent of the company's capital. The ceiling is lowered to 25 percent in specific financial sectors, including insurance.

C. Free zones

Companies established in the United Arab Emirates' free zones are exempt from compliance with the Companies Law with respect to matters governed by the regulations of the relevant free zone. Companies operating in the free zones are effectively treated as being offshore, or outside the UAE for legal purposes. Each free zone has its own rules and regulations and it is relatively easy to set up business in the free zones. Each free zone is governed by an independent Free Zone Authority (FZA), which among other things is responsible for issuing to businesses the necessary operating licences for operation within the relevant free zone.

The free zones in the UAE generally guarantee the following incentives to investors:

- 100 percent import and export tax exemptions,
- 100 percent foreign ownership with no involvement of a local partner or sponsor,
- No local sponsorship requirements,
- 100 percent repatriation of capital and profits,
- No currency restrictions,
- No corporate taxes for a set period which is renewable,
- No personal income tax.

1. Free zones in Dubai:

The choice of the appropriate free zone depends on commercial suitability and cost efficiency. The free zones in Dubai include:

- Jebel Ali Free Zone (JAFZ)
- Dubai Internet City Free Zone
- Dubai Media City Free Zone
- Knowledge Village Free Zone
- Dubai International Financial Centre (DIFC)
- Dubai Airport Free zone (DAFZ)
- Dubai Cars and Automotive Park
- Dubai Gold and Diamond Park
- Metals and Commodities Free Zone
- Dubai Silicon Oasis Free Zone
- Dubai Maritime City Free Zone
- Dubai Aid City Free Zone
- Dubai Healthcare City Free Zone
- Dubai Textile Village Free Zone
- Heavy Equipment and Trucks Free Zone

A free zone entity trading outside the free zone, but within the UAE, needs to appoint a UAE company as a trade agent, and the five percent customs duty is applicable when goods are exported from the free zone to a place within the country but outside the free zone. These restrictions or duties do not apply to trading conducted either within the free zone or outside the UAE.

2. Business forms within a free zone

a. Free Zone Establishment (FZE)

A Free Zone Establishment is a legal entity with only one partner where the liability of the company is limited to the registered capital. The amount of required registered capital varies according to the free zone. In Jebel Ali and Dubai Airport Free Zone the required capital is Dhs1,000,000.

b. Free Zone Company (FZCO)

Free Zone Company is similar to the Free Zone Establishment but there can be from two to five shareholders. Minimum required capital for FZCO is generally Dhs500,000.

c. Free Zone Limited Liability Company (FZLLC)

The terms Free Zone Company and Free Zone Establishment are not used anymore in the newer free zones. Free Zone Limited Liability Companies can be founded as partnership companies with one or more shareholders. The several free zones usually have their own regulations regarding structure and administration of these entities.

III. Taxation

A. Types of taxes

There are no federal tax laws. Instead, each emirate has its own income tax decree. With respect to Dubai, the Income Tax Ordinance of 1969 specifies that an organisation that conducts trade or business, including the rendering of any services in Dubai, is subject to tax. However, in practise the only companies on which income tax is imposed are the oil and gas producing companies and the branches of foreign banks. This is also the case in the other emirates.

There is no personal income tax, and there is currently no VAT. VAT is expected to be introduced by 2009. The customs tariff is generally five percent.

There are municipal taxes on the rent of properties by foreigners and on the transfer of property, and service taxes in hotels and restaurants.

B. Withholding taxes

There are no withholding taxes imposed in Dubai.

C. Double tax treaties

The UAE has double taxation agreements with various countries. The government considers double taxation agreements as being important to encourage foreign direct investment flows. The UAE has entered into many double tax treaties, including those with Algeria, Austria, Belarus, Belgium, Canada, China, Czech Republic, Egypt, Finland, France, Germany, India, Indonesia, Italy, South Korea, Lebanon, Malaysia, Mauritius, Morocco, Mozambique, New Zealand, Pakistan, Poland, Romania, Singapore, Spain, Sudan, Syria, Tajikistan, Thailand, Tunisia, Turkey and Turkmenistan.

D. GCC Custom Union

CGG Custom Union commenced in January 2003. Since then there are no custom duties in intra GCC trade. The common customs tariff of the GCC Customs Union is five percent on all foreign goods imported from outside of the Customs Union. The first port of entry in the GCC States inspects the imported goods, verifies their conformity to the required documents, ensures that they do not contain any prohibited commodities and collects the applicable customs duties. Foreign goods imported into the GCC States from the free zones are subject to the customs duties when exiting these zones.

E. Anti-avoidance legislation

As tax is not imposed, other than on oil producing companies and banks, there is no tax anti-avoidance legislation.

IV. Trusts

A. Recognition of trusts

Common law trusts are generally not accepted in the UAE. However, a *waqf*, a concept in Islam for the holding of certain property for the benefit of certain philanthropy and only in accordance with specific objectives, is recognised under Shariah law and may be considered a form of trust.

Within the Dubai International Financial Centre, an “Investment Trust Law” (DIFC Law No. 5 of 2006) was introduced in 2006 in conjunction with both the Collective Investment Law Amendment Law and the Regulatory Law Amendment Law. These laws apply only in relation to business carried out in or from the DIFC, and together they provide the comprehensive legal and regulatory framework necessary for companies wishing to establish collective investment funds within the DIFC. These laws enable the structure and management of managed funds to be more flexible. Previously the only real options available within the DIFC to financial institutions and companies which wished to open up domestic public or even private funds were investment companies or investment partnerships.

B. Taxation of trusts

The income tax rate in DIFC is nil, and tax is consequently not imposed on trustees.

V. Recent developments

A. Dubai as an attractive location for structured finance and investment fund

Dubai is an attractive location for structured finance and investment funds. The tax free regime, and the supporting regulatory framework within the DIFC, has encouraged a recent growth in businesses, and supporting professional firms, involved in such activities.

B. Plans for Value Added Taxation

In October 2004 GCC Finance Ministers adopted a proposal to introduce VAT, whilst deferring a final decision to the respective heads of state. The VAT initiative is driven by the need for a more stable government revenue base, and the dwindling government revenues following the Customs Union. UAE (and the Dubai emirate within the UAE) has been in the forefront of the move to introduce VAT, and it plans to do so by 2009. Other Gulf States are expected to follow suit, and 2012 is the tentative GCC wide implementation date. A low and single rate is predicted, possibly a maximum five percent rate. However, currently there appears to be some concerns about the high inflationary impact, given the recent surge in inflation, lack of preparedness of the taxpayers, the impact on competitiveness and political sensitivities. The delays to the GCC monetary union could also delay the VAT introduction. VAT may also be less urgent within the GCC because of the present high oil revenues.

C. GCC common market

GCC common market commenced at the start of 2008. The common market applies to the nationals of the GCC states. The GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. The common market means harmonisation of regulations and setting of new legislations to encourage pan-GCC investment. Also, free flow of people, capital, goods and services is a major part of the common market.

D. Anti-money laundering

A Federal anti-money laundering law was introduced in 2002 (Federal Law No.4 of 2002). The law imposes a maximum seven-year jail sentence and a Dhs10 million (US$2.72 million) fine for money-laundering in the UAE. The conversion, depositing or transference of proceeds, for the purpose of concealing or disguising the illicit origin of such proceeds is a crime under the law. The law allows financial authorities to seize suspicious funds whilst investigations are taking place. Money laundering is defined as any act involving the transfer, conversion or deposit of property, or concealment or disguise of their true nature, knowing that such property is derived from any of the following offences:

- Trafficking in narcotics and psychotropic substances;
- Kidnapping, piracy and terrorism;
- Offences committed in violation of the environment law;
- Illicit dealing in firearms and ammunition;

- Bribery, embezzlement and damage to public property;
- Fraud, breach of trust and related offences;
- Any other related offences stated in the international conventions to which the State is party.

Financial, commercial and economic establishments operating in the country will be criminally liable for the offence of money laundering if it is committed in their names or for their financial account.

A Financial Information Unit has been established at the Central Bank to deal with money laundering and suspicious cases. Reports of suspicious transactions will be sent to the Unit from all financial institutions and other financial, commercial and economic establishments.

There is a ceiling of Dhs40,000 for the amount that may be brought into the country in cash or equivalent without the need for declaration. The settlement of transactions amounting to more than Dhs40,000 is required to be properly documented, and the identity of the investor verified.

There are a number of memoranda of understanding with other countries for the exchange of information.

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The Cragus Group *is a leading independent tax advisory firm based in Dubai with special focus on the Middle East and Africa.*