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ISSUANCE AND ATTRACTION OF LOANS BY UAE COMPANIES – FROM UAE AND NON-UAE COMPANIES, INCLUDING INTRA-GROUP LOANS

20 December 2024

Despite common prejudice, commercial loans are legal in the UAE and are widely used as an effective mechanism to fund a UAE company. However, there exist a number of aspects that need to be taken into consideration.

This alert outlines the key aspects in relation to B2B loans issued by regular commercial companies (not banks or other financial institutions).

I. A loan in the UAE – general considerations

Commercial loans in the UAE are regulated mainly by the Commercial Code¹.

A large number of provisions are optional for the parties: e.g., the parties are free to agree on the term of a loan, whether it will be interest-bearing or interest-free, whether default interest will apply, whether a loan can be repaid prior to the maturity date, etc.

¹ UAE Federal Decree-Law No. 50/2022 Issuing the Commercial Transactions Law (the “Commercial Code”).

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However, there exist certain mandatory provisions applicable to commercial loans, such as the following:

- The maximum interest rate is 9% per annum (previously, the cap was 12% per annum).
- Compound interest (i.e., interest on interest) is prohibited.
- In case of the borrower's default in payment, the lender may, in addition to default interest, claim further compensation, but only to the extent it has proved that: (i) the lender has suffered additional harm; and (ii) it was caused by the debtor's fraud or serious error².

Loans issued by commercial companies do not need to be secured, as opposed to bank loans which are required to be secured by "sufficient security"³.

Loan agreements are traditionally concluded in writing via signing and exchange of counterparts in hard copies, although technological means and soft copies are also recognized now.

II. Issuance of a loan to a UAE company

A. By a UAE company

There are very few restrictions for a UAE company to grant a loan to another UAE company. Specifically:

- No banking/regulated activity: issuance of loans by a regular commercial entity in the UAE should not be made *on a customary basis*⁴ or *by way of business*⁵, as otherwise it may be regarded as a financial activity which requires a license from the Central Bank of the UAE (the "CB UAE"). This is typically not applicable to holding companies whose main business is, among other things, to provide

financing to their subsidiaries. Further, major UAE free zones, such as ADGM and DIFC, have their own regulations on financial activities – if a lending company is registered in one of these free zones, provision of loans by way of business typically constitutes regulated activity requiring a permission from the relevant regulator – FSRA and DFSA (although intra-group loans and loans made in connection with the sale of goods or supply of services are excluded from such license requirement).

- No financial assistance to purchaser: under the Commercial Companies Law, applicable mainly to the UAE Mainland companies⁶, a UAE public joint-stock company ("PJSC") or any of its subsidiaries may not issue a loan / provide collateral to any person which would enable it to acquire shares in the PJSC – this would be regarded as prohibited financial assistance. Similar financial assistance restrictions may exist in the regulations of a particular free zone (e.g., ADGM).
- Related-party restrictions: please refer to section IV below.

B. By a non-UAE company

Although this is not explicitly stated in the relevant laws, a prudent approach would be that the restrictions applicable to UAE companies (as outlined above) should apply also to non-UAE companies extending loans to a UAE company. For instance, if a non-UAE company constantly issues loans within the UAE, it shall be duly licensed by the CB UAE, a non-UAE subsidiary of a UAE PJSC should not grant a loan to a company which would enable it to purchase PJSC's shares, etc.

² In court practice, a "serious error" is understood as a "mistake committed in a considerably great degree which is a form of omission and failure to take the necessary precautions but indicates a remarkable recklessness of the rights and carelessness of the obligations without considering the potential damage due to such recklessness" (see, e.g., Dubai Court of Cassation, 153/2007 (186)).

³ Article 409 of the Commercial Code.

⁴ Article 78 of UAE Federal Law No. 10 of 1980 concerning Central Bank, the Monetary System and Organization of Banking.

⁵ Certain ordinary B2B activities, such as provision of so-called "Short-Term Credit" (i.e., interest-free

unsecured loans with maturity of up to 12 months issued for purchasing of goods or services) and payment in instalments for goods or services, *if conducted by way of business*, may be carried-out only by licensed companies (Article 1.3 of Finance Companies Regulation by the Board of Directors of the CB UAE, effective from September 29, 2023).

⁶ UAE Federal Decree-Law No. 32 of 2021 On Commercial Companies (the "Commercial Companies Law") does not apply to companies incorporated in UAE free zones, if there is a provision to that effect in the relevant rules and regulations of the free zone, and unless such free zone companies operate within the UAE Mainland.

Apart from that, there exist restrictions on owning some real estate⁷ and certain other types of property⁸ in the UAE (what requires proper structuring and involvement of a local security agent / trustee for a non-UAE lender to take security over that property), but no actual restrictions / adverse consequences for non-UAE companies that issue loans to UAE companies.

III. Receipt of a loan by a UAE company

Receipt of a loan does not require any governmental license or authorization. Also, no stamp fee or registration is required in connection with disbursement of a loan.

Furthermore, if the loan is from a non-UAE lender, its receipt / repayment is not subject to any currency control restrictions / formalities on the side of the UAE.

Thin-capitalization rules also work differently in the UAE. Unlike in Russia or some Middle East countries, there exists no debt-to-equity ratio rule for the borrower; instead, there exist restrictions on deductibility of interest: i.e., interest payments can be deducted only up to 30% of the company's Earnings Before Interest Depreciation and Amortization (EBITDA)⁹ – this rule applies irrespective of whether a loan is from a related or external party.

IV. Intra-group loans

A. Related-party restrictions

Under the Commercial Companies Law: (i) no loan may be granted to a company in which a director of the lending company or his spouse, children, or any of his relatives (up to the second degree) owns more than 20% of its capital; and (ii) any transaction with a related party cannot be concluded without a corporate approval (for

transactions equal to or below 5% of the capital - the approval of the board of directors is needed while for transactions exceeding 5% - the approval of the company's general assembly is required).

Somewhat similar restrictions may exist in a particular free zone: e.g., the Companies Law in DIFC permits a loan or another form of financial assistance to a company in which the director of the lending company has at least 20% of the share capital, provided that: (i) 90% of the shareholders have granted consent to the transaction; and (ii) all directors have made a declaration that the transaction would not materially prejudice the company's and shareholders' interests nor render the company insolvent.

Additional restrictions or prohibitions may also exist in the company's constitutional documents.

B. Tax law considerations

In addition to general interest deductibility restrictions mentioned above, the Federal Tax Law contains a specific rule in relation to loans obtained, directly or indirectly, from a related party: no deduction will be allowed unless the borrower can demonstrate that such loan was not obtained with the main purpose of gaining a corporate tax advantage (no such advantage will be presumed where the lender is subject to corporate tax of at least 9% in the corresponding foreign jurisdiction). Also, any transaction (including, a loan) between related parties shall also meet the arm's length standard, what implies that such transaction is priced as if it would have been concluded between unrelated parties¹⁰.

The parties are viewed as related if, e.g., they are related, directly or indirectly, by ownership (50% or more) or through control (i.e., the ability of one

⁷ For example, the right to own real property in the Emirate of Dubai is, as a rule, restricted to UAE nationals, nationals of the Gulf Cooperation Council member states and to companies fully owned by these, and to public joint stock companies (Article 4 of Law No. 7 of 2006 Concerning Real Property Registration in the Emirate of Dubai), although there exists a list of areas where foreign ownership is allowed (Dubai Regulation No. 3/2006 On Determining Areas for

Ownership by Non-UAE Nationals of Real Estates in the Emirate of Dubai).

⁸ For example, foreign ownership in companies of strategic impact activities (such as, e.g., telecom, insurance) is restricted (Cabinet Decision No. 55/2021 On the Determination of the List of Strategic Impact Activities).

⁹ Article 30 of OAE Federal Decree Law No. 47 of 2022 Corporate and Business Tax (the "Federal Tax Law".)

¹⁰ Articles 31 and 34 of the Federal Tax Law.

person to influence another person, including, e.g., the ability to determine the composition of at least 50% of the board of directors of the other person, the ability to exercise significant influence over the conduct of the affairs of the other person, etc.).

V. Conclusion

Issuance or attraction of a loan is generally a rather straight-forward transaction in the UAE. Still, a number of aspects, such as, e.g., financial assistance or related-party limitations need to be taken into account both on the side of the lender and the borrower to ensure compliance with the relevant applicable laws and regulations (i.e., at a federal, emirate and/or a free zone level).



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