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Client Alert Commentary

Latham & Watkins Corporate Practice May 1, 2014 | Number 1682

An Introduction to Non-Profit Entities in the DIFC

While the free zone continues to focus on the financial services industry, the Non-Profit Incorporated Organisation (NPIO) represents an additional tool to attract non-profit entities.

While the Dubai International Financial Centre (the DIFC) remains primarily focused on the financial services industry, its stable and sophisticated legal and regulatory regimes have increasingly attracted organisations in the culture and arts, retail, leisure and — more recently — the non-profit sectors. To date, only a handful of non-profit entities have been established in the DIFC, but the more recently introduced regulations allowing the creation of NPIOs may lead to increased interest. This *Client Alert* examines both the pre-existing options in the DIFC and the NPIO — the first entity of its kind in the Middle East.

The DIFC

The DIFC is a federal financial free zone established pursuant to UAE Federal Decree No. 35 of 2004, UAE Federal Law No. 8 of 2004 and Dubai Law No. 12 of 2004. One of two financial free zones in the UAE (along with the Abu Dhabi Global Market, which is not yet operational), the DIFC occupies a physical territory of approximately 110 acres. The DIFC functions as an independent jurisdiction with a body of corporate and commercial laws and courts separate from those of the wider UAE. Entities established in the DIFC are regulated by the DIFC Registrar of Companies (the RoC). In addition, the Dubai Financial Services Authority (the DFSA), the DIFC's financial services regulator, regulates the provision of financial services in or from the DIFC.

While the majority of entities based in the DIFC are commercial companies, a number of non-profit organisations maintain a presence in the centre. These are non-profit industry bodies rather than charities in the conventional sense. The DIFC's focus on financial services most appropriately caters to this class of organisation, but the recently introduced NPIO model is not limited in sector and could fit any non-profit purpose permitted under DIFC and UAE laws. Non-profit entities should note that, outside of the DIFC, Dubai hosts a number of other free zones which may be worth considering — in particular the International Humanitarian City (the IHC). However, many of the non-profit entities considering a base in the DIFC will be industry bodies related to the financial services industry rather than "charities" in the conventional sense. Accordingly, the DIFC will often be the most appropriate jurisdiction for such entities.

DIFC Entities

DIFC law provides for the establishment of several different entity types, including:

- A company limited by shares (an Ltd.) and a limited liability company (an LLC) — each incorporated under DIFC Law No. 2 of 2009 (the DIFC Companies Law)
- The NPIO, which may be incorporated under the DIFC Law No. 6 of 2012, as amended (the NPIO Law) and NPIO Regulations of 2012 (the NPIO Regulations)

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- A special purpose company (an SPC)
- A limited liability partnership (an LLP) and a limited partnership (an LP)

We do not consider the LLP, the SPC or the LP in any detail here as they are typically not suited to the non-profit sector.

Ltd. vs. LLC

The Ltd. and the LLC are the two principal forms of corporate entity which may be established in the DIFC. This distinction is borrowed from Delaware and other US jurisdictions, which typically distinguish between a "*corporation*" (equivalent to an Ltd.) and an LLC. Notably, the DIFC employs the term "LLC" in the Delaware sense of the term, which bears little resemblance to those "limited liability companies" incorporated in the wider UAE outside of the DIFC under the Commercial Companies Law (UAE Federal Law No. 8 of 1984, as amended) (the CCL). The closest comparable entity within the DIFC to the onshore LLC is in fact the Ltd. and not the DIFC LLC.

A DIFC Ltd. has a share capital divided into shares (the holders of which are referred to as shareholders), whereas a DIFC LLC divides share capital into "*membership interests*" (the holders of which are referred to as members). The concept of a share capital is more commonly associated with a commercial venture. The minimum paid-up capital requirement in both cases is US$50,000. The liability of shareholders in an Ltd. and members in a DIFC LLC is limited to the amount unpaid (if any) on their shares or membership interests. The officers responsible for the day-to-day management of an Ltd. are referred to as directors, whereas the equivalent in a DIFC LLC are referred t o as managers. The DIFC does not require a DIFC LLC to appoint any managers, whereas an Ltd. must have at least two directors plus a secretary (who may not also be a director). A DIFC LLC is prohibited from issuing securities and may not raise capital by way of public offer. This restriction does not apply to an Ltd.

As a practical matter, most non-profit organisations in the DIFC choose the LLC rather than the Ltd. form, with the principal founder personally holding 100 per cent of the membership interest. However, nothing in the DIFC Companies Law prohibits a corporate entity from being a member of an LLC (or a shareholder in an Ltd.).

Ltd./LLC vs. the NPIO

The DIFC NPIO entity — introduced in 2012 pursuant to the NPIO Law and the NPIO Regulations — is specifically designed for entities operating in the non-profit sector. As with an Ltd. or a DIFC LLC, an NPIO is a legal entity with a personality separate from that of its members. However, unlike an Ltd. or an LLC, an NPIO does not have a share capital or membership interest, and therefore no individual or entity is required to serve as its shareholder or owner, and the minimum share capital requirements do not apply.

A degree of uncertainty remains as to how NPIOs will be used and regulated. Whereas the Ltd. and LLC are similar to their equivalents in more established jurisdictions, the NPIO is a more *sui generis* entity without significant international precedent. The NPIO's distinction between "members" and "founding members" is somewhat akin to an LP, but bears a similarity in other respects to (i) foundations established in certain US states (*e.g.*, Delaware and Maryland); (ii) an English company limited by guarantee; and (iii) entities established in civil law countries which lack the concept of a trust.

NPIOs are subject to a number of drawbacks and restrictions which potential new entrants or existing non-profit entities currently established in the DIFC under alternative structures may find unattractive. First, the fact that very few NPIOs have been established to date causes uncertainty. Next, the NPIO Regulations prohibit an NPIO from conducting "*financial services*" subject to DFSA regulation. The broad definition of “*financial services*” may capture certain limited licensed functions that an applicant may wish to conduct. The Ltd. or LLC structures leave this door open (subject to DFSA authorisation), whereas the NPIO does not. Third, the NPIO cannot be established “*for the purpose of commercial or financial gain for its Founding Members or Members of former Founding Members or Members*”. While this prohibition does not prevent the payment of a salary to NPIO staff, it may be problematic if the organisation as a whole is construed as a “*business*” for its founders. Fourth, an NPIO must name at least three founding members, whereas an Ltd. or LLC may be established with a single member. Fifth, the NPIO Law requires that the NPIO “*carry on its activities in the DIFC*”. This contrasts with the DIFC Companies Law which requires only that an Ltd. or LLC must carry on their “*principal business activity*” in the DIFC (emphasis added). While practice has yet to emerge, this difference may prove problematic and leave NPIOs unclear as to what (if any) activities they are permitted to perform outside the DIFC. The requirement to lease costly physical space in the DIFC presents a drawback common to all forms of DIFC entity (except the SPC, which is not appropriate for non-profit organisations). Finally, an NPIO must contain the term “*Non-Profit Organisation*” or the letters “*NPIO*” in its name.

Set-up Process

As for applicants seeking an Ltd. or an LLC, the set-up process for an NPIO generally involves an initial meeting with the DIFC Authority (the DIFCA) and submission to the DIFCA of a brief business plan. After the applicant satisfactorily answers any DIFCA questions, the DIFCA will issue its in-principle approval, at which point the process becomes an administrative process coordinated with the RoC. In parallel, the applicant must lease an office within the DIFC. Notably, this requires a physical office space, as the DIFC does not permit a “*nameplate*” registered office approach (except in the case of an SPC, which is not an appropriate entity for a non-profit organisation). However, we understand certain non-profit entities have shared a registered office with other entities, which the DIFC permits in certain circumstances. This option would be dependent upon obtaining a waiver from the DIFCA.

Conclusion

Non-profit entities (particularly industry bodies) active in the region will welcome the DIFC’s NPIO as an additional structuring option. However, whether the vehicle will take off and become the entity of choice for the non-profit sector in the Middle East remains to be seen.

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