

Transforming Sole Establishment to LLC: Is It Limitation of Liabilities or Exposure to Further Liabilities?

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Introduction

The 'change of legal status' from sole establishment to limited liability company ('LLC') is a common 'licence' transaction introduced by various relevant licensing authorities in the UAE. There are two major situations where the concept of the change of legal status is implemented: the first is the sale of a business (sole establishment) to third parties who intend to continue the business under limited liability form; and the second is when the owner aims to continue the business under limited liability status. It is purported to be a practical solution to ensure the continuity of the licence's 'existence' at the commercial register.

Notwithstanding the concerns regarding the validity of the terminology and the legal basis of the concept, this article will focus on the implementation of 'change of legal status from sole establishment to LLC, with special consideration given to the general liabilities associated with the transaction. The first section of this article will tackle the practical application of the concept, and the second section will focus on the liability implications.

Practical Application

This section will discuss the main legal provisions that govern the concept of change of legal status from sole establishment to LLC, and the purpose of introducing such a procedure by the licensing authorities.

The transformation from sole establishment to LLC is not an established concept under a specific regulation in UAE, however it is a practical procedure that was introduced by the concerned licensing authorities in the various Emirates, with the ultimate purpose of keeping the same trade licence number

for the business entity once the change of legal status from sole establishment to LLC is effected. The benefit of keeping the same trade licence number is to maintain a practical continuity for the business in its relationships with third parties, and in particular with governmental authorities, as the licence number constitutes the principal means by which businesses are identified. Accordingly, the establishment's cards, establishment's accounts, etc. with the various authorities (such as immigration, labour office, Etisalat) do not need to be closed upon the conversion transaction. Instead only a simple amendment is required in order to reflect the change in the trade name and the status. Actually, the conversion transaction can be considered as a combination between two legal procedures as explained below:

1. **creating a LLC as an independent corporate entity** in accordance with the provisions of the Federal Law No. 2 of 2015 on Commercial Companies ('2015 law'). The 2015 law provides for an exclusive list of the forms of corporate entities, among which is the LLC;
2. **transferring the ownership of the sole establishment**, in accordance with the provisions of the Federal Law No. 18 of 1993 on the Commercial Transaction Law (the '1993 law'). The concept of the sole establishment (business premises, also referred to as a sole proprietorship) is found in Article (39) of 1993 law, titled 'business premises'.

Article (39) provides that:

"business premises constitute a group of tangible and intangible assets allocated for the practice of Commercial Activities"

Furthermore, Article (40) provides that:

"The main elements in the sole establishment are divided in two different categories which are as follows:

1. **tangible elements:** such as the goods, equipment, machines, tools ;and
2. **intangible elements:** such as the clientele (customer contacts), goodwill, trade name, right to let, industrial, literary and artistic patents and licenses."

Thus, compliance with the provisions of 1993 law that govern the transfer of ownership of the sole establishment (represented by its tangible and intangible elements) constitutes a major requirement in the process of converting a sole establishment to a LLC. The essential consequence for not complying with the provisions of 1993 law is the exposure of the owners to additional liability towards third parties.

Liability Implications

The transfer of ownership of the sole establishment involves two main steps: namely the registration of the disposal transaction in the commercial register; and the notification of the disposal (publication).

Registration of the Disposal Transaction in the Commercial Register

Pursuant to Article (42) of 1993 law, in order to be valid, any agreement related to the transfer of

ownership of a sole establishment must be legalised and registered in the commercial register.

The registration of the disposal in the commercial register shall be deemed completed upon performing the following procedures, as specified under Article (45) of 1993 law:

1. *"The officer in charge at the Commercial Register shall, at the request and expense of the purchaser, publish a summary of the sale agreement in two Arabic local newspapers with an interval of one week between the two publications.*
2. *The summary published shall include the names of the contracting parties, their nationalities and places of residence, specification of the subject, total price and grant the creditors the right to submit their objections within ten days from the date of the last publication.*
3. *Objections specifying the amount of the debit and its cause shall be submitted to the competent Civil Court in the jurisdiction where the business premises is located.*
4. *The purchaser shall refrain from paying the price until the competent Civil Court makes a ruling on the objection. However, the seller may make a request for the summary judge to authorize him to cash the price even before the objections are looked into, if he provides sufficient guarantees for the settlement of the creditors' rights.*
5. *Any objecting creditor or mortgagor may offer to purchase the business premises for himself or for a third party for a price exceeding by at least one fifth the price agreed upon.*
6. *Any person objecting to the price shall deposit at the court treasury a sum equal to at least one third of the original price in addition to the increase offered by him.*
7. *The competent Civil Court shall notify the offers of increase to the contracting parties for the sale of the business premises and twenty days after such notification the specialized Civil Court shall decide the sole of the business premises shall be sold to the person having offered the highest price."*

Hence, in the case of a failure to fulfil the requirements of the registration as mentioned above, including the publication of the summary of the transfer of ownership agreement in two Arabic local newspapers with an interval of one week between the two publications, the transfer of ownership shall be considered invalid. The invalidity in this case will be applicable among the contracting parties and in relation to third parties, in accordance with the provision of Article (44) of Law 1993.

Notification of Disposal

Following the registration of the disposal in the commercial register, the person to whom the title to the business premises has devolved (the purchaser of the sole establishment) shall perform additional obligations in accordance with Article (47) of 1993 law as follows:

- the purchaser shall fix a period for the creditors holding debts prior to the notification of the disposal, in order to submit a statement of their debts for settlement. Such period shall be published in two local newspapers issued, one of which is in Arabic and with an interval of one week between the two publications. The period fixed to the creditors shall not be less than ninety days from the date of publication. The purchaser shall remain liable for the debts, if the creditors of such debts submit a statement thereof within the said prescribed period and if such debts are not settled within such period;
- however, the purchaser shall be released of any debts in circumstances where the creditors do not produce a statement within the prescribed period as set out in the previous paragraph;
- furthermore, the disposing party shall remain liable for the debts related to the business premises which arose prior to the notification of the disposal unless he is discharged therefrom by the creditors.

Therefore, in the case of the failure to fulfil the notification of disposal by the purchaser, both the disposing party and the purchaser will remain jointly liable for any debts. It is worth mentioning that, in practice, it is possible to complete the conversion of a sole establishment to a LLC without completing the notification of disposal requirement, however, a question as to joint liability on the part of the disposing party and the

purchaser (the shareholders in the newly formed LLC) may arise.

Conclusion

The change of legal status from sole establishment to a LLC originated from a procedural practice adopted by various licensing authorities in the UAE, and can be viewed as a combination between two legal procedures creating a limited liability company as well as transferring the ownership of a sole establishment.

Conceptually, the aim of introducing the change of legal status from sole establishment to a LLC is to move from the position of unlimited liability to the status of limited liability. It is worth mentioning that the 'change of legal status' transaction involves essential provisions regarding the transfer of ownership of the elements of the sole establishment, with specific requirements related to the notification of creditors and publication. Therefore, special consideration should be given to the accurate fulfilment of the notification and publication requirements during the transaction; otherwise, the parties (seller/purchaser) may remain jointly liable for any debts related to the business. It is worth noting that such notification and publication requirements amount to, in general, an obligation on the part of the purchaser, hence, in practice, the licence of the sole establishment can be amended to reflect the new LLC status, even before the completion of the notification and publication requirements.

Moreover, in any event the Seller shall be liable for any debts related to the sole establishment and which may have arisen prior to the notification of the disposal unless it is discharged from such debts by the creditors.

Al Tamimi & Company's [Corporate Structuring team](#) regularly advises on liabilities related to corporate structuring. For further information, please contact [Ali Bachrouh](#) (a.bachrouh@tamimi.com) or [Odai Mismar](#) (o.mismar@tamimi.com).