

Piercing the Corporate Veil of an LLC in the UAE

The Limited Liability Company in the UAE (the “**Company**”) is one of the most commonly used and preferred legal form of companies for investors, whether foreign or local. There are several reasons for this, the main one being that the Company has a separate legal personality from its shareholders, whose liability is generally limited to their contribution to the Company’s share capital (known as the “**Corporate Veil**”).

This Corporate Veil was confirmed in two Articles of the UAE’s Federal Decree Law No. 32 of 2021 on Commercial Companies (the “**Law**”). Article 21 of the Law provides that a Company shall become a separate corporate entity as of the date of its registration in the Commercial Register at the competent authority, and Article 71 stipulates that the liability of each shareholder is limited to the extent of its contribution to the share capital of the Company.

However, there are certain cases in which the Corporate Veil can be pierced, rendering the shareholders personally, and in some cases jointly, liable for all the debts and liabilities of the Company. These cases can be summarized as follows:

1. If the Company was not properly incorporated in accordance with the Law, or has been declared void by a court order, any shareholder concluding a contract in the name of the Company with a third party will be personally and jointly liable for all the obligations arising from such contracts (Articles 9 and 16(2) of the Law).
2. If the Memorandum of Association of the Company contains any false or untrue provisions with respect to a shareholder’s contribution to the Company’s share capital, whether in cash or in kind. Articles 8 and 76 of the Law require a shareholder’s contribution to be in cash or in kind and it must be paid in full at the time of incorporating the Company, as this is the only security that the Company’s creditors have, and the shareholder’s liability is limited to that amount.

Such false or untrue statements are considered to be in violation of the Company’s incorporation principles, rendering the Company void. The Company may in certain cases be treated as a de facto company (one which operates as if it were a company, although it has not completed all the necessary legal steps) and in such cases its shareholders could be held jointly and severally liable for the Company’s obligations and debts.

3. If the Company has distributed any fictitious profits or has violated any provisions of the Law, the Company’s creditors will have the right to demand the shareholders repay such profits, even if the shareholders received them in good faith (Article 30 of the Law). The Law also criminalizes and may impose penalties on any person who distributes such profits contrary to the provisions of the Law (Article 348 of the Law).
4. If the number of shareholders of the Company exceeds fifty (as stipulated in Article 71 of the Law) and the Company fails to rectify this by reducing the number of shareholders within a maximum period of 3 month following receipt of notice from the local authority, the Company will be considered dissolved and its shareholders will be jointly and severally liable for all the Company’s debts and liabilities from the date on which the number of shareholders exceeded fifty, unless this was due to inheritance or a court order (Article 75 of the Law). This does not apply to any shareholders who were unaware of the excess number of shareholders or objected to it.

5. If a shareholder's contribution to the Company's share capital was a "share in kind" and the valuation of the contribution provided by the shareholder is found to be above its true value, the shareholder will have to pay the difference in cash to the Company and will be personally liable towards any creditor for any discrepancy between his valuation and the true value of his share (Article 78 of the Law).
6. If the Company is being managed by one or more of its shareholders, such shareholders could be held jointly or severally liable for the Company's debts and liabilities in the following circumstances:
 - a) If they fail to indicate in their dealings with third parties on behalf of the Company that the Company is a Limited Liability Company (Article 72);
 - b) If they fail to register the Company's Memorandum of Association and each amendment thereto with the authority (Article 15); or
 - c) If the Company is declared bankrupt and it is proven that such shareholders:
 - i) are responsible for the Company's losses in accordance with provisions of the Law and the Company's assets appear to be insufficient to settle 20% of its debts; or
 - ii) have, within the two years prior to the commencement of the bankruptcy proceedings: recklessly disposed the Company's assets at prices lower than their market value to obtain money to avoid or delay the commencement of bankruptcy procedures; or entered into transactions with third parties to dispose the Company's assets without consideration or with insufficient consideration; or paid debts to any of the creditors thus causing damage to the other creditors (Article 246 of the UAE's Federal Decree Law No. 51 of 2023 Promulgating the Financial and Bankruptcy Law – the "**Bankruptcy Law**").

In addition to the above, the local courts have ruled in several judgments that the Corporate Veil may be pierced or ignored if it is evident that one or more shareholders have used it as a cover to conduct any fraudulent or deceitful activity, and such shareholders shall be personally and jointly liable for such activities.

Although the local Courts in the UAE have rarely pierced the Corporate Veil, they will not hesitate to do so and confirm the personal liability of one or more shareholders in any of the above mentioned circumstances.

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