

Holding Companies Under Iraq's Amended Companies Law

In the second half of 2019, the Iraqi Parliament amended the Companies Law, thereby legalising the registration of holding companies in Iraq and limiting foreign ownership in a holding company to less than 50%.

This article analyses this amendment in terms of how it defines holding companies, the relationship between holding companies and their dependent companies, reporting requirements, ownership of movable and non-movable property, the right to invest, the shareholders of holding companies and the management of subsidiaries. The article also discusses certain loopholes and contradictions in the amendment, as well as conflicts with investment laws, the Banking Law and the Competition Law.

Au deuxième semestre 2019, le Parlement irakien a modifié la loi sur les sociétés, légalisant ainsi l'enregistrement des sociétés holding en Irak et limitant la propriété étrangère dans une société holding à moins de 50%.

Cet article analyse cet amendement en termes de définition des sociétés de portefeuille, de la relation entre les sociétés de portefeuille et leurs sociétés dépendantes, des obligations de déclaration, de la propriété des biens mobiliers et immobiliers, du droit d'investir, des actionnaires des sociétés de portefeuille et de la gestion des filiales. L'article examine également certaines lacunes et contradictions dans l'amendement, ainsi que les conflits avec les lois sur l'investissement, la loi bancaire et la loi sur la concurrence.



Muqdad Sami Alwan Al-Juboori

Managing Partner
AI-Muhamoon Al-Mutahidoon
Legal Consulting, Baghdad



Dr. Hadeel Adnan Anwar Al-Ani

Partner, International Law and Investment
Dispute Settlement and Arbitration Group
AI-Muhamoon Al-Mutahidoon Legal
Consulting, Baghdad



Othman Ayad Khalaf Al-Juboori

Senior Associate
AI-Muhamoon Al-Mutahidoon
Legal Consulting, Baghdad

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On 9 September 2019, Iraq issued Law No. 17/2019 (the "Amendment" or the "Holding Companies Amendment") amending Law No. 21/1997 promulgating the Companies Law (the "Companies Law"). The Amendment legalises the registration of holding companies in Iraq and sets out the registration procedure. Based on the grounds stated in this Amendment, the legalisation of registering holding companies in Iraq was passed for the purpose of supporting the national economy and encouraging the entry of foreign capital into the Iraqi market; nevertheless, the Amendment's limitation of foreign ownership in a holding company to less than 50% is in conflict with this objective and, in our opinion, needs to be reconsidered given the negative impact limiting foreign ownership will have in attracting foreign companies and investors to the Iraqi market.

Definition of a Holding Company

Article 7, paragraph 1, clause (a) of the Holding Companies Amendment defines a "holding company" as follows:

"A Holding Company is a joint-stock company or a limited company that controls a joint-stock or limited company/ companies referred to as the dependent companies."

The same article also lists the cases under which the holding company is considered as in control of another company or companies:

- 1) Where the holding company owns more than the half of the other company's capital and controls its management, in case of a limited company; and*
- 2) where the holding company has control over the other company's board of directors, in the case of a joint-stock company."*

The same article also states that the holding company name must include the word "Holding" in addition to its type, and include this word within all documents, advertisements, and correspondence issued by the company.

It seems that the Iraqi legislator has considered the same definition of "holding company" adopted by Jordanian Companies Law No. 22/1997. However, the Iraqi Law has distinguished between (i) control by a holding company: of a limited company by owning the majority of shares and controlling its management, and (ii) control by a holding company of a joint-stock company. This distinction is appropriate, since it is possible for a holding company to control a subsidiary of a public joint-stock company, despite owning less than 50% of the shares, by means of an agreement with the shareholders to control the management.

Ownership of Property

Paragraph 2 of article 7 of the Holding Companies Amendment states that *"the holding company aims to support the national economy"*. We think that including this phrase represents an intrusion of a political expression into a commercial law. Establishing commercial works does not necessitate the support of the national economy, especially since the majority of holding companies are going to be foreign companies with the objective of earning a profit.

Furthermore, article 7, paragraph 2, clause (a) states that the holding company is entitled to *"own movable and immovable properties within the framework of its activities."*

Iraqi law prohibits ownership of immovable property (such as land) by foreigners (individuals and corporations). Article 4 of Law No. 38/1961 on Real Estate states:

"It is prohibited for non-Iraqis to own real estate in Iraq, for whatsoever reason, neither may they buy real estate in a selling bid except after the following conditions are met and following approval of the Minister of Interior:

The person has been resident in Iraq for a period of no less than seven years;

The absence of any administrative or military prohibition;

The real estate is not within 30 km of the Iraqi border; and

The real estate is not a farm or owned by the State."

Article 5 of the same Law states:

"It is prohibited for non-Iraqis to own real estate in Iraq exceeding one place for housing and for working, provided that the non-Iraqi must have a profession to personally practise in that place."

The prohibition is also cited in other Iraqi laws, such as Law No. 43/1971 on Real Estate Registration (articles 155 and 165), and article 1199 of Iraqi Civil Code (Law No. 40/1951).

As an exception, article 2, second paragraph, clause (a) of Law No. 13/2006 promulgating the Foreign Investment Law allows the ownership of lands by certain foreign investment projects:

"The Iraqi and foreign investor have the right to own lands and properties belonging to the State in exchange for an allowance calculated in accordance with a specific regulation. The investor has the right to own lands and properties owned by mixed and private sectors for the exclusive purpose of establishing housing projects."

This provision is likely to raise an ambiguity in its implementation in the near future. The scattered provisions within various laws—likely to confuse both investors and law enforcers—will likely require legislative intervention given.

Shareholders

Article 2, second paragraph of the Holding Company Amendment states:

"A natural or legal Iraqi person is permitted to acquire membership as a founder or a shareholder in joint-stock companies and limited companies, provided that the percentage of the Iraqi person contribution is no less than 51% percent of the company capital"

In our opinion, this limitation of foreign ownership is a strange development, a regression, and an obvious contradiction that is not in line with the objectives of the Amendment.

The Iraqi legislator has thereby prohibited foreigner ownership of shares in a limited company or a joint-stock company from exceeding 49% against 51% owned by a local. In our opinion, this limitation of foreign ownership is a strange development, a regression, and an obvious contradiction that is not in line with the objectives of the Amendment allowing the incorporation of holding companies. The Amendment allows the holding company to control or own other companies (dependent companies), while it requires the majority of a dependent company shares to be owned by a local, which is inconsistent with the principle of control. This legislative contradiction needs to be resolved.

The Amendment does not, however, include a mechanism for changing the legal status of a company in which a foreigner currently holds the majority of its shares. Thus, no legal action is required by those companies at this stage while it applies to the companies incorporated after the Amendment effective date.

Creation of and Investment in Dependent Companies

Clause (b) second paragraph of article 7 grants holding companies the right to:

"incorporate dependent companies under its management or participate in managing other companies where the holding company is a shareholder."

This provision allows for the incorporation of subsidiary companies and for the holding company to become a shareholder or to participate in the management of a company. The question here arises as to whether this text applies to companies in which the government owns a portion of the shares, especially government-owned companies offered for investment in participation with the government.

Clause (c) of second paragraph of article 7 states:

"Holding companies have the right to invest its monies in stocks, bonds, and securities."

Although it is axiomatic for any duly registered company with commercial objectives to invest in stocks, bonds and securities, the text was included to eliminate any possible argument in this respect. In addition, clause (d) of the second paragraph of article 7 states:

"Holding companies have the right to make loans and provide guarantees and financing for their dependent companies."

Practising such activity, we believe, will nevertheless require action from the Central Bank of Iraq so that these companies will not be considered to be engaged in lending and financing activities under article 3 of Law No. 94/2004 promulgating the Banking Law, or adjustments on the part of the holding company to ensure compliance with the applicable laws in this respect.

On another level, clause (a) of paragraph 3 of article 7 of the Holding Companies Amendment restricts ownership of shares in a holding company by a subsidiary company. While clause (b) of the same paragraph allows the holding company to appoint its representatives to

the board directors of the dependent company in proportion to the percentage of its shares, it prohibits the holding company from participating in the election of other board members of the dependent company. By this, the legislator probably wanted to prohibit the holding company from illegal control of the joint-stock company decisions and to protect the rights of the dependent company's minority shareholders.

Reporting Obligations

Paragraph 4 of article 7 of the Holding Companies Amendment requires the holding company to prepare a consolidated balance and a statement of profit and loss for the holding company and all its dependent companies, supported with clarifications and confirmed statements in accordance with the requirements of international accounting criteria. The annual financial statements must be submitted with the Companies Registration Directorate and Tax authority on an annual basis. In case of delay submitting the annual financials following the due date specified by each authority, fines will be imposed.

The Amendment, however, does not indicate whether the holding company will be subject to tax, nor the type of taxes to be levied based on the holding company activities where its dependent companies have already been subject to tax.

Paragraph 5 of article 7 of the Holding Companies Amendment states the Companies Law will continue to apply to any area not covered under the Holding Companies Amendment, in accordance with the type of the activities of the company.

Contradictions with the Banking Law

It should be noted here that the first reference to the term "Holding Company" in Iraqi Law was in Law No. 94/2004 promulgating the Banking Law, issued by the Coalition Provisional Authority. Article 1 of the Banking Law (which remains valid) states that:

"The banking holding company is defined as a company that owns or controls a bank."

Article 1 of the Banking Law also states:

"The term "holding company" refers to a company that controls a specific bank and any other specified company in accordance with the criteria specified under the regulations of the Central Bank."

Another reference to the term "holding company" should be noted under article 5 of the Banking Law, which states:

"To declare whether the applicant company is dependent on a foreign bank or on a foreign banking holding company, stating that the external regulatory authority responsible for supervision of the applicant company in the country of incorporation of the foreign bank or foreign banking holding company has no objection to the applicant establishing the intended operations in Iraq, and that the external regulatory authority is exercising a consolidated supervision over the applicant company."

Article 13 of Banking Law states:

"The involvement of the bank or the foreign bank or the banking holding company of which the bank is dependent, or involvement of a company dependent on the bank, in criminal activities, including fraud, money-laundering, terrorist financing."

The provisions in the Banking Law raise the following question on Iraq's judicial competence if a foreign holding company is involved in criminal acts but a company or bank operating in Iraq is not involved in illegal acts. Will the dependent companies be considered as an extension to the holding company or will they be treated as independent companies?

Clause (I) of the same article states:

"Obstacles faced by the Central Bank in supervising a bank that is a member of a group of companies, or that is a subsidiary of a foreign bank or foreign banking holding company not subject to adequate supervision."

While Clause (J) states:

"To be the foreign authority in charge of exercising supervision over a bank or foreign bank or a banking holding company on which the bank is a dependent company, has appointed a trustee or a judicial guardian for the bank or the foreign bank or the holding banking company."

In any event, the Holding Companies Amendment may be considered as part of a set of amendments by which the Iraqi government is attempting to attract foreign investment in support of the national economy, in line with the common structure of multinational companies which often have a holding company requiring legal recognition in order to be able to enter the Iraqi market. However, these amendments are still limited. They are procedural and regulatory in nature and do not represent substantial amendments but rather an ongoing response to the rapidly growing international commerce.

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The Companies Law and Law No. 31/1984 promulgating the Commercial Transactions Law were passed over 20 years ago. Both laws belong to a different era have their origins in a totalitarian economic system. Many of their articles are not consistent with free market principles and Iraq's free trade agreements. It is necessary to reconsider the legislative system as a whole for the purpose of creating a legal environment free of loopholes and missing pieces that could confuse both those in charge of law enforcement and those involved with the commercial sector.

Competition Law Considerations

It is also worth noting that Law No. 14/2010 promulgating the Competition and Anti-Trust Law (the "Competition Law") states in article 9:

"It is prohibited to merge two or more companies engaged in any restricted commercial practice if the company or group of companies resulting from the merger or acquisition controls 50% or more of the total production of a specific good or service or controls 50% or more of the total sales of a specific good or service."

A "restricted commercial practice" is defined as any practice may only be carried out by specialised companies, such as telecommunications, electricity and energy services.

Although holding companies are not explicitly mentioned and the article is limited to mergers, the phrase "any restricted commercial practice" necessarily means a restriction in the formation and incorporation of holding companies if the elimination of competition and consequent monopoly result from its activities, in violation of Competition Law. Article 9 represents a general text with no specific criteria to guide companies when forming holding companies. Furthermore, it does not include any transitional articles to take into consideration companies that are restructuring in accordance with the law. This could be done, for example, by granting companies a reasonable grace period to legalise their status, provided the market criteria are unfixed and subject to multiple factors.

تقدم هذه المقالة تحليلاً لهذا التعديل بما في ذلك تعريفه للشركات القابضة والعلاقة بين الشركات القابضة والشركات التابعة لها ومتطلبات تقديم التقارير وملكية الممتلكات المنقولة وغير المنقولة وحقوق الاستثمار والمساهمين في الشركات القابضة وإدارة الشركات الفرعية. كما تناقش هذه المقالة أيضاً ثغرات معينة وتناقضات في التعديل وكذلك تناقضه مع قوانين الاستثمار وقانون المصارف وقانون المنافسة.

BIOGRAPHY

MUQDAD SAMI ALWAN AL JUBOORI is the Managing Partner of Al Muhamoon Al Mutahidoon Law Firm in Iraq. Mr. Al Juboori has a Bachelor of Law from the University of Baghdad and is a member of the Iraqi Bar Association and the International Bar Association and is the author of multiple published articles. Mr. Al Juboori advises national and international clients. His main areas of expertise are civil litigation before all levels of courts as well as the Federal Supreme Court of Iraq and Iraqi High Tribunal, commercial law litigation, banking, investment and arbitration.

DR. HADEEL ADNAN ANWAR AL-ANI is a partner at Al Muhamoon Al Mutahidoon Law. She is an arbitration consultant with more than 23 years' experience in arbitration and dispute resolution. Dr. Al-Ani obtained her Bachelor of Law from the University of Baghdad, a diploma in Legislative Law at the Institute of Arab Research and Studies, a Master's Degree in the International Law at the Institute of Arab Research and Studies, a Ph.D in International Law from the Faculty of Law-Ain Shams University. Dr. Al-Ani was previously a senior legal consultant at the Integrity Commission advising on public employee negligence, anti-corruption acts and practices, and related regulations to eliminate corruption. She also acted as Director of International Relations Department at the Office of Commission President, and was the Commission Representative in the United Nations Convention Against Corruption "UNCAC" Treaty. She has also been a senior legal consultant at the Property Disputes' Body. Dr. Al-Ani is the author of numerous articles, a member of Iraqi Bar Association, and the Arab Jurists' Union and Human Rights Association.

OTHMAN AYAD KHALAF is a Senior Associate in the corporate group at Al Muhamoon Al Mutahidoon Law. He holds a Bachelor of Law from Al Mosul University and advises clients on commercial, corporate, tax and social security law. He is a member of Iraqi Bar Association and Iraqi Jurists' Union. Following his graduation, Mr. Khalaf rapidly took the lead as a corporate lawyer when he joined Al Hadeel Al Hasan firm, providing services to national and international institutions in Iraq. Supported with the experiences he earned in the corporate sector, he was attracted by Eversheds Sutherland and appointed as the leading lawyer of the corporate department. Following his time at Eversheds Sutherland, he joined Al Muhamoon Al Mutahidoon Firm as a partner successfully leading the corporate department. Mr. Khalaf had represented numerous multi-national clients various in corporate cases, before the Registrar of companies, taxes, social security in addition to representation before Iraqi courts.



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