

# Trusts: in succession planning

**Richard Catling** - Partner - Corporate / Mergers and Acquisitions / Commercial / Family Business / Private Equity / Venture Capital and Emerging Companies

r.catling@tamimi.com - Dubai International Financial Centre



## The problem with Succession

In a recent Gulf Family Business Council report, in the next decade approximately US\$1 trillion in family owned assets is due to transition to the successive generations.

The central issue on which any person of advanced years and with substantial assets should focus, is the outcome of the emotional turbulence and practical upheaval that their passing may create. These issues are magnified in the Middle East due to the, often, substantial numbers of successors that founders of successful businesses in the region tend to have.

With more inheritors comes more interests for which the founder must have regard. Unfortunately, such circumstances may also lead to more opportunities for disputes to arise.

Primarily, anyone looking to pass substantial wealth to the next generation would, to any extent possible, be concerned to ensure that any succession happens as seamlessly as possible, so that their inheritors are cared for in the manner intended.

Therefore, any legal structure that makes it possible to plan in advance and to enshrine the wishes of a founder, prior to their passing, such that those wishes will be respected after their death, must remain the only real way of providing that individual with certainty for the future.

In family run and owned businesses, in particular, the founder will have been the guiding light and glue that the family will have relied upon for decades to provide guidance and direction. In such circumstances,

such an individual's passing creates the propensity for seismic events to occur which could have profoundly negative consequences for wealth preservation and the continuing success of any family owned business.

## **Trusts - a Middle Eastern perspective**

Historically in the western world, the primary means of securing an individual's legacy has been the trust. Quite apart from the tax advantages that trusts provide (which whilst may not currently be of primary importance to all residents in the region should be of concern with the future in mind) the inherent nature of a trust, and the disposition of assets into a structure which can exist for perpetuity, means it represents the optimal means of securing the future after an individual's passing.

In the GCC trusts law has been one of the most innovative and interesting developments in terms of jurisprudence in recent years. Together with Bahrain which has its own trust law, the Qatar Financial Centre, the Dubai International Financial Centre ('DIFC') and the Abu Dhabi Global Market have all ensured that trust legislation has enabled trusts to be established in these jurisdictions in line with best international practice.

In particular, the DIFC's enactment of the Trust Law No.4 of 2018 (which superseded the Trust Law No. 11 of 2005) is perhaps the clearest example of a modern trust law which 'cherry-picks' particular elements of varying trust codes in order to provide a framework for founders of businesses to best plan for succession.

Whilst trusts are by no means the only way to provide for wealth management for successive generations (and the common law environments of the financial centres mentioned above means that shareholding structures can also be designed to capitalise on the best practice that modern common law can provide), they do offer a number of advantages over purely corporate structuring options. This is because of the intrinsic separation of the legal and beneficial interest in the underlying assets that the trust creates, which enables a stable asset holding structure as family members change over the years. Furthermore, the trust is an inherently flexible arrangement and, as such, is ideally suited to the needs of a family looking to create a framework for its own particular requirements.

In addition, given the location of the trusts within the respective countries' legal environments, the regulatory and legal issues which may prohibit the holding of onshore assets in an English law governed trust, for example, do not apply, meaning that a local domiciled trust may be particularly attractive for families with both onshore and offshore assets.

## **Creating stability for the long term**

At its heart a trust constitutes the separation of the legal and beneficial interest in an asset, and it is this bifurcation of interests which creates the inherent attractiveness of trusts when it comes to succession planning. By placing the settlor's wealth in a legal structure which operates outside the direct legal estate of the settlor, the effect is that those assets are ring-fenced and separated from the direct legal estate of the settlor. Rather the assets are held legally by a trustee, who acts, on the basis of a trust instrument and the underlying requirements of a trustee under the trust law, in the furtherance of the settlor's wishes.

Whilst interested persons (i.e. family members) may not have a direct claim to the legal ownership of assets, they do, as beneficiaries enjoy a right, depending on the nature of a trust, to either enjoy a fixed share in the underlying assets, or a right to be considered by the trustee when it makes decisions regarding the disbursement of the capital and income of the trust. These decisions can be recorded in the

trust instrument or a separate letter of wishes to ensure that the trustee is bound by them. In this way both the interests of the settlor and the beneficiary are served; on the one hand the settlor can be confident that following his passing the trustee will ensure the maintenance of the asset base without undue interference enabling the prudent payment of future income, whilst the beneficiaries know that they will receive the entitlement to share in the trust assets in accordance with the founder's wishes.

This separation of interests also lends itself to good corporate governance when housed in a holding structure for diverse business interests. By separating out the management and control of the assets (which in the context of a family business structure would be the shares held in various subsidiaries through holding companies) a corporate trustee with a board comprised of both key family members and independent directors can ensure the stewardship of a business without the competing demands of other family members whose own immediate interests may not align with those of the business.

## **The flexible nature of trust arrangements**

Aside from the intrinsic characteristics of a trust, the requirement for a trustee, identifiable beneficiaries (or any class thereof) and identifiable assets, the attractiveness of a trust arrangement is its inherent flexibility. Not constrained by maintenance of capital rules or shareholder rights, a trust can be designed to accommodate any variety of family arrangements. Usefully they can be used to give legal backing to the usual model of family arrangement, i.e. the family constitution (which is rarely enforceable in the courts due to its non-binding nature and reliance only on moral force).

The flexible nature of a trust lends itself to family business arrangements where family members' interests may not be aligned with those of the business. Whereas in a shareholder/company arrangement the shareholders retain the direct ability to exert direct influence on the officers of the company, a trust can ensure the clear separation of those interests.

At the same time a trust can also have regard to the need and requirements of individual beneficiaries in a way that a company cannot, constrained as it is by restrictions imposed by company law. In practice this can mean that the ability to provide liquidity and the ability for inheritors to exit can be facilitated, whilst at the same time ensuring that these events do not threaten the stability of the trust. This 'escape valve' can be a key tool in enabling beneficiaries to leave the family business over time without having to resort to contentious proceedings to extricate themselves, with the potential for irreparable damage that may ensue.

## **Sharia compliance**

To Middle Eastern ears, trusts may seem to be a western concept and therefore incongruous in the context of inheritance laws reflecting the principles of Islamic Sharia. However, it is entirely possible to align those principles with a trust to ensure that the fixed proportions to which inheritors become entitled are applied by the trustee on the passing of the settlor, whilst at the same time ring-fencing the underlying assets in a trust. In the case of assets being shares in businesses, this protects the businesses from the almost inevitable disruption caused by a sudden change from one founder to multiple stakeholders.

# **A key component of modern estate planning and wealth management**

Whilst trusts may have a long pedigree, they remain a key structuring solution for wealth preservation and stewardship of family businesses. For many years the Middle East has benefitted from private bankers and wealth managers with the skill set necessary to provide investment solutions to ensure the growth of privately held assets. However, in recent years, it is the advent of trust regulations and the arrival of trust advisors and fiduciary service providers that means that the complete solution now exists to ensure that family owned businesses remain the mainstay of the regional economy for decades to come.

*Al Tamimi & Company's [Family Business practice](#) regularly advises on trust arrangements and other related matters. For further information, please contact [Richard Catling \(r.catling@tamimi.com\)](mailto:r.catling@tamimi.com).*