

# Building Trusts and Succession in the Middle East: Advisory Guidance from the DIFC Court of Appeal

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On 13 January 2021 the DIFC Court of Appeal handed down its first ever judgment under Article 5(B)(1)(b) of the Judicial Authority Law, being its exceptional advisory jurisdiction to hear and determine requests by the Chief Justice, upon the application of any DIFC Body or Establishment, for the interpretation of DIFC laws or DIFC regulations.

In the proceedings, bearing the DIFC Claim No. CA-002-2020, the Dubai International Financial Centre Authority ('DIFCA') sought answers from the Court of Appeal to 13 questions relating to how the DIFC Trust Law and the DIFC Foundations Law impact persons or property in jurisdictions that do not recognise trusts or have no equivalent provision for statutory Foundations.

In accordance with the consultative character of the reference, the Court of Appeal (Chief Justice Zaki

Azmi, Justice Robert French and HE Justice Ali Al Madhani) invited and benefited from participation in the proceedings by representative bodies and legal practitioners active in private client and wealth management structures in the UAE. In particular, Al Tamimi & Company ('ATCO') made extensive written submissions and participated fully in the oral argument on each of the issues and questions before the Court.

The common thread underpinning the questions was the concern to elucidate how common law trusts and DIFC Foundations, as recognised or governed by DIFC law, could be reconciled as a matter of practicality with Shari'a law rules and principles on inheritance forming part of onshore UAE law and other jurisdictions in the Middle East and further afield.

The interest of DIFCA in bringing the case, as noted in the judgment, is that one of the objectives of the DIFC from its inception has been to provide a platform, comparable to other international financial centres, from which family wealth can be administered, protected and transmitted. In this regard, family wealth makes up a significant part of the Gulf economies, and experience has shown that common law trusts are frequently at the heart of successful wealth management structures and succession planning in other international centres. Yet private client advisors in the Gulf region are often unfamiliar with or uncertain about the compatibility of common law trusts, or more recently about the compatibility of UAE Foundation structures, with local laws.

Against this background, the Chief Justice was persuaded, and the DIFC Court of Appeal accepted, that its interpretive judgment on the questions asked could assist in addressing a relative dearth of precedents and guidance on trusts and Foundations in its existing jurisprudence.

## **Trusts, Awqaf and Foundations in UAE Law**

In common with other civil law jurisdictions in the Middle East, until recently UAE law did not recognise the common law trust, but it has long provided for a similar endowment structure in the Waqf (plural Awqaf), which traditionally has been used for charitable purposes and occasionally to hold shares in a local company. Awqaf are the subject of specific laws in each of the Emirates of Dubai and Sharjah as well as at UAE national level and in a preponderance of GCC jurisdictions.

Notwithstanding, foreign-established trusts are frequently used by Muslim and non-Muslim settlors alike to hold UAE assets, for example shares in local companies or real estate, and for this purpose, under the DIFC Trust Law, corporate trustees established in the DIFC are able to own UAE assets. This freedom is subject only to complying with rules presently restricting: (i) foreign ownership of limited liability companies (LLCs), which at the time of writing are being abolished or substantially eased in respect of the majority of sectors of commercial activity; and (ii) the current practice of the regulators of land departments in the various Emirates that results in the need to engage with them to obtain specific approval for trust structures holding land.

The conflict of laws position under the DIFC Trust Law, and also under the equivalent ADGM regime, is that trusts will not be voidable by reference to any foreign law. This extends to Shari'a law, which does not form part of DIFC or ADGM or other UAE financial free zone law. However, a difficulty arises in cases where a local UAE court is called upon to recognise a distribution of assets under a DIFC trust made for succession planning when the distribution is contrary to mandatory Shari'a principles, particularly those codified in the UAE Law of Personal Status.

This specific difficulty is not overcome by the enactment at the end of 2020 of the UAE Trust Law, which introduces, for the first time in UAE law, a *sui generis* concept of trust drawn from common law concepts but incorporating some features typical of civil law property rights. In particular, the UAE Trust Law does not apply to trusts created in any UAE financial free zone, and for the purposes of foreign trusts the law stipulates that any foreign trust that is inconsistent with mandatory provisions of public policy shall not be

enforceable.

Against this backdrop, the newly emergent statutory Foundation has emerged as an alternative mechanism for ensuring succession of private wealth in the UAE. In particular, Muslim founders can establish a Foundation under DIFC law, or under ADGM law, or under the equivalent regulations of the RAK International Corporate Centre ('RAK ICC'). A Foundation is an independent legal entity with a distinct personality, separate from the founder. This allows the Foundation to enter into contracts or hold assets in its own name. It is governed by its charter and by-laws, reflecting the desires of the founder, and it is managed by a council composed of several members appointed by the founder (who in turn may be supervised by a guardian appointed by the founder).

In some important respects, a Foundation is more rigid than a trust: the use of the assets for commercial purposes is not possible for Foundations (although they can hold shares in a commercial company), but is allowed for trusts; furthermore, a Foundation must be registered and usually will have an unlimited lifespan, whereas trusts are not registered and may be limited in time.

Notwithstanding, Foundations present founders with additional flexibility, when compared to a trust structure, including notably as to the continuing powers and influence of the founder and the operational advantages of being a distinct legal entity that owns assets and enters into contracts in its own name. In a trust relationship, by contrast, the trustee legally owns the assets and enters into contracts on behalf of the beneficiaries; further, the use of the assets for the benefit of beneficiaries is optional for Foundations, whereas it is mandatory for a trust other than a charitable or purpose trust.

It is fair to say that these advantages, and the growing understanding by government authorities and land/planning departments in recognising and facilitating the holding of property by Foundations, have led to a gradual but steady increase in the use of foundations in family wealth holding structures in the Middle East. Often these are linked with associated special purpose vehicles and funds' structures established under DIFC or under ADGM law or indeed under other international offshore financial centre laws.

It remains to be seen how the new UAE Trust Law will impact the choice of trust structures in the UAE to manage private wealth. As a general proposition, the introduction of the law will assist in assuring clients of what was already known to specialist practitioners, namely that the creation or maintenance of trust structures to manage family assets gives rise to no conflict with UAE law or UAE public policy, including any conflict with Shari'a principles forming part of UAE public policy, save in the specific context where mandatory rules on Shari'a inheritance constrain the inheritance ratio of trust property which was settled on the trust during the lifetime of a deceased Muslim settlor and is required to be distributed on his or her death.

As appears from the summary and analysis that follows, much the same can be said for the advisory judgment of the DIFC Court of Appeal in Case CA-002-2020, in which the Court took the opportunity to clarify that many perceived conflicts in this area between UAE law and public policy, on the one hand, and DIFC law (and common law) on the other, are more apparent than real.

## **The advisory judgment**

In its judgment the DIFC Court of Appeal emphasised that its advisory jurisdiction under Article 5(B)(1)(b) was an exceptional one, to be exercised with circumspection and properly confined to matters that bore on a legitimate practical purpose in the administration of the law. Even then, the Court had a discretion not to answer a question where the answer might affect a large range of factual situations and cases which might be better off left for determination on a case by case basis.

In the present case, the Court declined on jurisdiction or discretionary grounds to answer 7 of the 13

questions, however it is apparent from the judgment that, in respect of all questions, the Court took care to provide as much helpful guidance as it could, consistent with its advisory and adjudicative functions, on the areas for consideration. Taken in the round, the judgment is a careful and welcome exposition of how key provisions of the DIFC Trust Law and the DIFC Foundations Law apply and may impact in a private client context on persons and property located outside the DIFC, including in jurisdictions where inheritance is subject to Shari'a law.

For the purposes of this short article, the 13 questions, and the advisory answers given by the DIFC Court of Appeal, can be succinctly identified and briefly explained in turn as follows:

- **Question 1** correctly anticipated that property held in a trust structure may be located in a jurisdiction that does not recognise trusts. Although this point might appear obvious to common law trust practitioners, it was nonetheless a point of practical importance when considering the imposition of trust structures over arrangements including assets held onshore in the UAE.
- **Question 2** correctly anticipated that a DIFC Foundation may hold property (other than property of the Foundation) in trust under the Trust Law, adding additional flexibility when considering the establishment of private wealth structures in the UAE that would otherwise require a private trust company to be established (and for which arrangements need to be put in place for the holding of shares therein).
- By its answer to **Question 3** the Court confirmed that the “common law of trusts and principles of equity” referred to in Article 10 of the Trust Law is the common law of trusts and principles of equity as determined by the Courts of the DIFC from time to time drawing upon the common law of England and Wales and other common law jurisdictions as they see fit.
- By its consideration of **Question 4**, the Court declined to answer a question directed to whether a national of a third country might have an interest in trust or foundation property which by the law of the UAE or any other specified country could only be held by a national of that country. The Court explained that there were too many circumstances in which a person may assert an interest in trust property or foundation property to provide a global answer to the question posed.
- **Question 5** correctly anticipated that trustees could rely upon the Shari'a law advice of an advisory trustee appointed under Article 57 of the Trust Law, whilst noting that the trustees are not bound to do so and must act at all times in accordance with the Trust Law, the common law and principles of equity applicable to the trust. In other words, as had been submitted by ATCO, the principles of Shari'a are no different from any other consideration upon which advice is given, and where there is a conflict the terms of the trust prevail over those principles.
- The Court declined to answer **Question 6**, which was directed in three parts to whether a waqf could be recognised as a trust under Article 17 of the Law Relating to the Application of DIFC Laws or could be recognised or continued as a DIFC Foundation under Articles 62 and 56 respectively of the Foundations Law. In so ruling the Court accepted as a matter of general principle that some and possibly most waqfs, having no distinct legal personality in their place of establishment, might be recognised as trusts. It equally accepted that many waqfs with legal personality might be recognised as Foundations. However, in both contexts, the question was in all cases for determination on a case-by-case basis, requiring careful review, and in the Court's assessment the question asked was primarily one of application rather than interpretation of the Trust Law and the Foundations Law.
- By its consideration of **Question 7**, the Court similarly accepted that there is no general prohibition against the re-domiciliation of a Foundation to another jurisdiction where it would continue as a waqf. However, this was again a question of application to be decided on a case by case basis, involving an assessment by the DIFC Registrar as to whether the proposed continuance in another jurisdiction might adversely affect creditors of the Foundation, and was therefore unsuited to an advisory answer in the abstract.
- The Court declined to answer **Questions 8, 9, 10 and 11** on the grounds, in each case, that the issues raised by these questions were not matters of interpretation of any DIFC law or DIFC regulation, and they therefore fell outside the Court's exceptional advisory jurisdiction. Of these, the conclusion on three of the questions was quite straightforward, because it was clear on analysis that they either related to the way in which foreign laws (including the Judicial Authority as a Dubai law) might approach the recognition and enforcement of DIFC trusts or, in the case of Question 11, to whether DIFC law generally (and not

any identified provision of DIFC law) prevented a settlor of a trust from being a shareholder or director of a corporate trustee.

- Notwithstanding, the Court by its answer to **Question 10** helpfully stated that, on its face, there was no reason why the general enforcement provisions of Article 7 of the Judicial Authority Law should not apply to DIFC Court orders made under the Trust Law or the Foundations Law.
- The Court's treatment of **Question 9** deserves more careful scrutiny, as it related to the important question, in practice, as to whether the transfer of property by a Muslim to a DIFC Trust or DIFC Foundation would necessarily attract the operation of Article 361 of the UAE Law of Personal Status. This issue had been the subject of submissions by DIFCA and by ATCO that had evolved and been refined in the course of the proceedings, to the point that, in support of DIFCA's proposed answer that there was nothing in either DIFC law that would offend against UAE inheritance law and so bring about the nullity of trusts or Foundations, the Court might adopt the following sequence of propositions:
  - Shari'a inheritance rules do not form part of the public policy of the DIFC within the meaning of the Trust Law or the Foundations Law;
  - Article 361 of the UAE Law of Personal Status does not form part of DIFC Law;
  - in the case of a DIFC trust, the terms of the trust may or may not conflict with Shari'a inheritance rules. Whether it does so will depend on the terms of the trust, and the Trust Law has no impact on the question;
  - a settlor wishing to establish a trust that will respect Shari'a inheritance rules in its operation will be able to do so;
  - no issue arises as regards the validity of prior dispositions to a trustee to be held by the trustee on trust during the lifetime of the deceased (apart from any period of death or illness); and
  - a testamentary disposition to trustees of a trust or a Foundation contrary to Shari'a inheritance rules raises no issue under the Trust Law or the Foundations Law. It may however raise an issue of foreign law (including the law of other parts of the United Arab Emirates) where that law is the applicable law governing the validity of the disposition and includes Shari'a inheritance rules because Article 13(2)(c) of each of the Trust Law and the Foundations Law provides that DIFC law shall not validate any testamentary trust or disposition which is invalid according to the laws of the testator's last domicile.
- In the event, the Court declined to adopt these propositions, or to answer Question 9, as the cascading answer proposed was an invitation to the Court to make a general statement about the interaction between the Trust Law, the Foundations Law and the Law of Personal Status going beyond the boundaries of its advisory jurisdiction. It is also of note, however, that the Court saw fit to set out these propositions in its judgment without comment, and to that extent to give some prominence to them as points that might be helpful to practitioners and tested in future practice in this area.
- **Question 12** was directed to the question whether the DIFC Court had power in appropriate circumstances to give effect to a settlor's true intentions by varying a trust (and make consequential orders) so as to be Shari'a compliant, as intended. The Court confirmed that there was nothing in Articles 24, 25 and 40 of the Trust Law that would preclude the Court from avoiding the mistakenly made disposition or varying the trust as the case may be. In so confirming, the Court stressed the importance of keeping in mind, as had been submitted by ATCO, that in all cases the key consideration was the settlor's intention, there being no suggestion that dispositions creating trusts or that the terms of trusts themselves should be Shari'a compliant.
- The final question, **Question 13**, admitted a straightforward answer in the negative: the public policy of the DIFC as referred to in Article 9(2)(c) of the Trust Law, was directed only to the purpose of a trust, and therefore it did not preclude the establishment of a non Shari'a-compliant trust by a person who was not and never had been a Muslim. In so concluding, the Court noted the several ways in which, in the submissions of DIFCA, DIFC law treated testamentary and non-testamentary dispositions by non-Muslims who are not UAE nationals.

## Conclusion

In recent years, the urge to regularise and secure private wealth has meant that common law trust and Foundation structures in the relevant free zones have been and continue to be the primary means by

which local assets can be effectively held. The nexus between the common law under which the DIFC and ADGM operate and the onshore civil law environment has naturally resulted in a need for the refinement of this inter-relationship and, at times, for clarification from the relevant judicial authorities.

The advisory judgment of the DIFC Court of Appeal is a welcome intervention and milestone in this ongoing process of invention and refinement. In particular, the judgment provides authoritative guidance that, viewed from the viewpoint of DIFC law, the requirements of Shari'a and UAE public policy can be accommodated within structures that take advantage of the special features of common law trusts and Foundations. The judgment should therefore assist as a matter of practicality in advising settlors and founders in the region on the range of stable options for the management of their private wealth.

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*The power games in **Succession** remind us that, whilst every family has its traditions, to survive they will often need some agreed rules.*