

Succession Planning: The case for private interest foundations

by Alyzeh Zahid - a.zahid@tamimi.com - Dubai Maze Tower

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‘Succession Planning’ is a term now trending in the Middle East.

The notion of preserving family legacy and the resulting need to prepare the business to “hand the baton” to the next generation makes sense. Most private businesses in the region are family owned and many of them are reaching the transitional stage of handover from the founding generation to the next.

However, the legal topography of the Arabian Gulf is unique because civil law and Islamic law principles both have their respective place in the regulatory framework. In matters of succession planning those legal principles have to be considered by Muslim families.

To add another dimension to this Middle Eastern legal landscape, there are islands of common law rules which apply in the Dubai International Financial Centre (DIFC) and also now the recently launched Abu Dhabi Global Markets (ADGM) free zones. These freezones can be described as self-governing icebergs in a regional sea of civil law. Whilst these icebergs, although subject to many of the Federal laws of the UAE, have their own dedicated laws and regulations and their own court systems in place, unlike the Titanic, these icebergs don't sink ships! In fact the DIFC has proven to be vital in developing commerce and attracting investment in the region and the ADGM seems set to follow in these footsteps (though currently it is in its infancy).

In light of the above environment, various options have opened up for succession planning in the Middle East. Some of these structures include the setting up of limited liability companies, establishing Waqf-Al Ahlis (family Waqfs), setting up common law system trusts under DIFC and in some instances, even going public with the family business.

This article will touch upon another attractive structure for families which should be considered for recognition, namely the private interest foundation.

There is no existing legal basis for implementing private interest foundations in the Middle East as there are currently no laws in place addressing this concept. However, this structure has enjoyed considerable success elsewhere in the world. This structure could provide a credible option in the future for succession planning as it has the potential to combine both, civil law and Islamic law principles, the dominant legal themes in the Arabian Gulf.

What are ‘private interest foundations’?

Foundations are governed by a charter or their by-laws. A foundation, whilst an entity with its own legal personality, is not a company and does not issue shares or other titles of legal ownership. Most often foundations are associated with charitable, religious or educational purposes and are often non-profit organisations. Jurisdictions like Panama, Austria and Jersey use private interest foundations as a means of succession planning and preserving family wealth.

How can private interest foundations work for succession planning?

Usually a foundation is set up by the founder who owns the business being transferred under the ownership of the foundation. The foundation is managed by a board of directors or a council whose responsibility is to manage the foundation assets. The board of directors are often nominated by the founder and will have their powers set out in the foundation charter.

The foundation charter is a private document and can be drafted in a manner compliant with Islamic principles, if desired. This is significant. In some jurisdictions such as Panama, a “guardian” or a “protector” can also be appointed by the founder in addition to the board. The guardian or protector is independent from the board and its role is to monitor the board to ensure that the foundation assets are being managed in a manner consistent with the founder’s objectives.

The benefits derived from the assets in the foundation are paid to beneficiaries who are often the heirs in the manner specified in the foundation charter. After the demise of the founder, foundations are believed to become irrevocable entities, however the foundation charter can specify if the foundation needs to be wound up after a period of time or upon a triggering event.

This type of structure offers many benefits to family businesses including enabling the founder to give detailed instructions on the vision of his business for the future and on the distribution of benefits to beneficiaries without raising concerns over the validity of the foundation. If properly recognised in the law, they offer more certainty than Waqfs due to the differing schools of jurisprudence in relation to Waqfs.

Importantly, assets under the foundation are owned by the foundation itself and not the founders or beneficiaries which provides a degree of separation between the wealth and the owners of the wealth. This results in wealth preservation and helps guard against misuse of assets.

The challenge facing the credibility of a private interest foundation structure as a tool for succession planning in the Middle East is the absence of a legal framework. At present, families in the region can only set up foundations in off-shore jurisdictions such as Austria and Panama. These off-shore foundations would be treated as foreign entities and would not enjoy national status and therefore would not be able to hold land, businesses or other assets under their name in the Middle East. In the event of a dispute, it is also not certain whether Middle Eastern courts would currently recognise private interest foundations as a valid structure.

The Way Forward

On the basis of the above, there is a case to be made for introducing a legal framework on private interest foundations in the Middle East.

Introducing such legislation would provide family businesses the means to set up a succession planning structure that is autonomous of local corporate laws and is self-sustaining.

Theoretically, introducing such a law would also not require changes to be made to local laws since foundations are not technically classified as ‘entities’.

The importance of planning for the future seems to have dawned on stakeholders in the Middle East as dialogue on succession planning issues is gaining momentum. Private interest foundations could be attractive and effective vehicles for succession planning, not least because they are flexible and elegant as trust solutions, yet offer the advantage of additional compatibility with the civil law systems which prevail in the Middle East.