Trusts in Family Business Structures

by Richard Catling - r.catling@tamimi.com - Dubai Maze Tower

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Introduction

Given that the very nature of a trust used for the purposes of the protection and preservation of family wealth is one of longevity and permanence, giving effect to a trust in family circumstances should be a unique ‘one-off’ event. The fact that only until relatively recently has the option of using a family trust become available to families in the UAE, in relation at least to wealthy families’ UAE assets, usages of trusts cannot be said to be commonplace.

Yet in many ways the trust represents the panacea to many of the otherwise intractable problems faced by families considering the preservation of family wealth. The ability now for families to draw on the common law to provide for the protective benefits of a trust means that trust arrangements are now starting to be used regularly for enlightened families who appreciate the flexibility and effectiveness that these legal structures can provide.

Consideration of the use of trust structures can often lead to families asking further related and very necessary questions as to how to restructure their businesses. Conglomerations of interests which have grown organically over time may require substantial pruning and reorganisation to ensure longevity and stability. Whilst the optimal family business structure is never a ‘one-size fits all’ model, more often than not a trust arrangement will be the cornerstone of any reimagined family structure.

For over a decade the UAE has, in the form of the DIFC Trust Law (recently amended and updated in 2018), offered the option of a trust but in recent years, with a better understanding between various Governmental organisations in Dubai and the DIFC, the trust has become the optimal choice for the holding of family business interests. In particular companies incorporated in the Dubai International Financial Centre are now treated as national companies, provided they meet normal requirements under UAE law (namely that they have UAE national shareholders). The DIFC now represents a viable and tested option for incorporating holding structures of ‘on-shore’ family assets, meaning that a trust established in the DIFC can accommodate even the most complex of family arrangements.

An elegant solution to complex problems

Control and Governance

The transition of family assets across generations results in a number of issues which strike at the heart of the viability of ownership, and central to that is the fragmentation of family interests caused by the application of the inheritance laws applicable in the UAE as elsewhere in the region.

The result of an increased number of stakeholders is primarily one of control. Individual direct ownership by inheritors in any structure, but especially a shareholding arrangement incorporated under the Commercial Companies Law, can render governance and decision making almost impossible given the capacity for disagreement and for shareholder fractions to form. It is not uncommon on a transition, especially in a business unused to a multiplicity of voices, for the result to be paralysis of decision-making and even the hindrance of the running of the business on a day-to-day basis, with potentially disastrous consequences.

At its heart, a trust is a separation of the legal and beneficial ownership of an asset, and this separation of interests allows ownership rights to be shared between trustee and beneficiaries. For family businesses this important characteristic is the key to putting in place an arrangement which can protect the many interests of a widened family ownership whilst at the same time insulating the governance of the business by incorporating a management structure that is distinct from ownership.

Via either a discretionary arrangement or the ownership of fixed interests in the beneficial interest in the trust, family members can hold an entitlement to income and capital from the underlying businesses and assets held within the consolidated ownership structure held in its entirety by the trustee.

Inherent Flexibility

In establishing a trust, families are not constrained by anything other than the fundamental trust principles in law upon which trusts are founded. Without reference to external regulators or the notary, the trust deed can be tailor made to the precise specifications of the family. Governance, limitations to, and the extent of, beneficiaries' individual interests, restrictions on the transfer or securitisation of those interests and policies as to income from those interests can all be provided for.

In addition it is possible to ensure that a trust follows the Sharia inheritance principals or indeed that the settlor's express intention that the interest in the trust remains within either a narrow or wider family grouping, such that the trust will weather the births, marriages or deaths occurring within the so defined family beneficiaries.

Exit Mechanisms

Not only would a trust structure put in place by foresighted families enable a smooth transition of ownership on the passing of the initial generation, but it would also ensure that the arrangement continues in the future given that individual family member's beneficial interest would not grant any particular holder, on their own, any effective means of disrupting business operations or seeking to change any holding structure put in place.

Notwithstanding that the inherent nature of the trust can be used to provide stability from the perspective of the family business, a well-considered structure will also take into account that quite often the interests of individual family members may not always align with those of the family as a group. The flexibility of trust structures means that the prospect of stakeholders having interests which are distinct from the business can be provided for in ways that would not be possible in common company structures available under the Commercial Companies Law.

Issues such as the inability for companies to buy-back interests of stakeholders, lack of liquidity and the requirement for unanimous consent on transfers all combine to stop exits and conversely encourage stakeholder argument. These issues can be circumvented in a trust by enabling either the trustee to have the discretion to, or to be required to, allow exits based upon a cashing out of beneficial interests in a manner which is not possible under normal ‘on-shore’ company rules without reference to external controls.

Certainty of outcome

Whilst many families are perhaps comfortable with trusts through their holding of assets in other jurisdictions, the imposition of a trust to hold assets in the UAE may still be a leap into the unknown and understandably concerns may be had as to the lack of wider recognition of such arrangements. It is comforting to know, therefore, that it is possible, in a well-structured trust arrangement, to ensure that disputes arising in respect of the trust have reference to the courts of the DIFC, staffed with predominantly common law judges trained and well versed in trust law doctrines and practice, rather than the ‘on-shore’ local courts which are not so experienced in trust law.

It is also possible, before there is any reference to court, to include mediation or another similar conciliatory option as the means of dispute resolution, the court being the least appropriate forum for the resolution of family disputes. If mediation fails, the last resort can be a compulsory and confidential arbitration process under the rules of the DIFC-LCIA Arbitration Centre.

Whilst a well drafted trust deed produced by expert advisors should provide adequately for the possibility of longevity and therefore most likely outcomes, it is almost impossible to document every possible issue that may arise as the facts and circumstances of the family’s arrangements change over the years. However, if unforeseen gaps or circumstances emerge in the operation of family arrangements, trust law doctrines and jurisprudence developed over time make available to the adjudicator the possibility to chart a course and enable the trust to accommodate such issues. Consequently, the settlor of the trust can be assured that their arrangements will be respected by the ultimate arbiter of any dispute.

Confidentiality and Disclosure

Whilst the recent inclusion of the UBO Regulations in 2018 in the DIFC means that a DIFC trust cannot be used to shield from the regulators assets which would otherwise be disclosable in any event ‘on-shore’ in the UAE, the regulator does recognise that family trust arrangements are private, and as such the documentation can remain confidential with no obligation to disclose to any interested person and no requirement to notify any public body (subject to the UBO Regulations) of day-to-day movements in the trust.

Conclusion

The establishment and administration of a trust is a complex matter but in the DIFC and likewise in ADGM in Abu Dhabi families have the advantage of drawing upon a premier network of expert legal and accounting services to deliver the services families need. The vast majority of businesses in the Middle East are family owned and for those families that wish to retain the significant proportion of their ownership and governance in the UAE, the DIFC and ADGM offer attractive options to operate family trusts from a UAE platform.

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) or Nawal Abdelhadi (n.abdelhadi@tamimi.com).