Trusts and the Middle East

Robert Brodrick is a senior solicitor in the private client department specialising in domestic and international tax and estate planning for wealthy individuals, their advisers and trustees. As well as the preparation of wills and trusts for domestic clients, Robert advises the owners of landed estates and heritage chattels, the beneficiaries of onshore and offshore trusts and corporate and individual trustees. Robert has been involved in the creation of structures for non-domiciled individuals who are intending to become resident in the UK, and has also advised on the establishment and reorganisation of structures for Middle Eastern Clients. Robert is a member of the Society of Trust and Estate Practitioners for whom he has lectured on “Trusts and the Middle East”.

Trowers & Hamilins is a City and International law Firm with 80 partners and some 500 staff. The Firm’s head office is located in Tower Hill in the City of London with regional offices in Manchester and Exeter. Overseas, the Firm is located in Abu Dhabi, Bahrain, Cairo, Dubai and Oman. The firm has a leading reputation in trusts, tax and estate planning. Trowers & Hamilins have a long-established reputation for providing a comprehensive service to private individuals and trustees, whatever form their assets might take and as a result of the firm’s network of Middle Eastern offices, they have experience in establishing suitable structures for Middle Eastern clients.

Robert can be contacted on:
Direct line: +44 20 7423 8027
Email: rbrodrick@trowers.com

Robert Brodrick explains why trusts are so attractive to Middle Eastern clients and why they are increasingly being used by families to deal with succession issues

TRUSTS AND THE MIDDLE EAST

People normally think about trusts in the context of tax planning, but in the Middle East trusts are increasingly being used by families to create long-term structures to deal with succession issues.

For Middle Eastern clients, the flexibility of using a trust can allow adherence to Islamic law and can also be a useful way of dealing with the issues of control that arise when trying to pass a family business on to the next generation. Trusts also offer confidentiality and can be a useful defence against third party claims.

The Middle East includes the six Gulf Cooperation Council (GCC) Arab Islamic States which are Bahrain, the United Arab Emirates (which comprises seven emirates of which the best known are Abu Dhabi and Dubai), Kuwait, Saudi Arabia, Qatar and Oman.

To understand why trusts are so attractive for Middle Eastern clients, you need to have a basic understanding of Islamic law - known as Shari’a law.

SHARI’A LAW

There are two main sources of Shari’a Law. The Quran which is the ultimate legislative authority and the Sunna - the words and actions of the Prophet Mohammed which interpret the Quran and provide a source of guidance for the followers of Islam.

Islamic faith is progressive and the methods of interpreting the Quran cater for change; where there is no express ruling in the Quran, Muslims may create a new ruling based on their inner sense of what is the appropriate rule in all the circumstances, looking to the Quran for guidance.

There are two main branches of Islam; the Shia and Sunni; the Sunni branch has four schools.

90% of Muslims are Sunni (although notably Bahrain is about 70% Shia). Sunni jurisprudence is based on a literal meaning of the Quran whereas Shia jurisprudence is based on an interpretation of the Quran which goes beyond its literal meaning.

Shari’a law is complicated by the fact that each school has different sources of jurisprudence, which means that although key elements of Islamic law are the same, the end result is non-uniform.
SUCCESSION UNDER SHARI'A LAW
Each school has slightly different succession rules.

The basic features of the Sunni branch of Shari’a succession include the following:-
(a) Testamentary freedom is limited to one-third of an estate if there is an heir or heirs entitled under the Shari’a forced heirship rules; the balance of the estate passes under those rules.
(b) No bequest of the disposable part may be made in favour of a person who is entitled to take as an heir (although the other heirs may ratify such a bequest).
(c) Under the Shari’a forced heirship system, only Muslims are entitled as heirs; non-Muslims are altogether excluded (although non-Muslims who are Christians or Jews (i.e. those who believe in revealed scriptures) can inherit from the part of the estate that is not subject to the forced heirship regime. This can give rise to curious results (e.g. a Jewish wife (with or without children) may inherit up to a third of her husband’s estate, whereas a Muslim wife with children would only be entitled to a one eighth share of her husband’s estate).
(d) There are three categories of heirs. The primary category is the near relatives of the deceased.

As the rules are likely to vary from person to person, it is often best to get what you are wanting to do blessed by the client’s Imam.

LIFETIME GIFTS
Lifetime gifts are not subject to the same Shari’a succession rules provided
(a) there is a clear defined proposal and acceptance with regards to the gift; and
(b) the gift is complete so that the recipient takes possession of the item.

Unlike many European civil law countries, there is no clawback in relation to lifetime gifts when the donor subsequently dies.

The major disadvantage of Shari’a forced heirship when it comes to family wealth is that the head of the family loses control of the family’s assets. Using a trust it is possible to respect the principles of Shari’a succession (at least in financial terms) without giving up control completely. In relation to lifetime gifts to trusts, provided the trust is validly constituted and funded during the donor’s lifetime, the trust assets should be outside the scope of Shari’a succession rules on the Settlor’s death, although the trust can be made to comply with Shari’a succession rules if this is what the donor wants.

There are several obstacles to being able to make a lifetime gift. Ownership is one issue, and in some civil law countries this can be complicated by matrimonial regimes. Taxation is another constraint, but generally there are no transfer taxes in the Middle East (although obviously if the assets in question are in a country like France or the UK there could be gift or inheritance tax consequences to consider).

Capacity to make a gift is also an important factor. Under Shari’a Law a donor does not possess legal capacity if he is suffering from “Death Sickness” - this is a period before death, to be ascertained from the circumstances of each case, when the donor is suffering a mortal illness or is under an urgent apprehension of death. It is a continuing process and would not normally be longer than a year before death.

If a gift is made in death sickness, it will be treated as a gift made on death rather than a lifetime gift and therefore Shari’a succession rules will apply. It is therefore vitally important to know your client’s state of health before embarking on any lifetime estate planning designed to avoid or alter beneficiaries’ entitlement under Shari’a succession law.

FOREIGN OWNERSHIP
Many of the Middle Eastern countries have restrictions on foreign ownership of companies, but individuals are generally free to transfer their overseas assets and a percentage of shares in local companies, provided that foreign ownership does not exceed a specified percentage (usually 49%) which varies from country to country (and which can often be raised with the consent of the appropriate minister).

FORMS OF TRUST
By using a discretionary trust, a Settlor can achieve a Shari’a compliant distribution of his assets. This would often be coupled with a detailed letter of wishes.

Alternatively, the Trust can be drafted so as to give the heirs entitled under Shari’a law fixed entitlements. This may require the Trustees to obtain the advice of an Islamic scholar on the correct distribution of the Trust Assets which may be time consuming and expensive to obtain.

In many cases the Settlor may not want the assets to be distributed in accordance with Shari’a law, and in certain cases may want certain people to be specifically excluded from benefit.

TRUSTEES
Setting up a trust involves transferring legal control of the trust assets to a trustee.
The trustee holds the assets for the beneficiaries and administers them in accordance with the terms of the Trust Instrument. In the case of a family business, the trustee may own shares in a holding company which will hold shares in one or more family trading companies.

The trustee may be a professional or non-professional person or a corporate trustee (e.g. a bank), but many people may be uncomfortable with the idea of handing control of the family’s business to a third party. One very effective solution is to use a Private Trust Company.

PRIVATE TRUST COMPANIES

A Private Trust Company is a private company that acts as trustee of one or more family trusts.

The directors of the company may include the Settlor or members of his family as well as professional advisers. The directors control the company which, as trustee, is the legal owner of the trust assets. The Private Trust Company is likely to be based in an offshore jurisdiction.

There are several ways in which the shares in the Private Trust Company may be owned. One option is to use a Purpose Trust - a special type of trust with no beneficiaries. Alternatively, an individual (e.g. a member of the Settlor’s family) may own the shares.

The identity of the shareholder of the Private Trust Company is important because the shareholder has the ability to replace the directors, which is another way of controlling the trust.

The Private Trust Company may also be a company limited by guarantee which avoids the need for shareholders.

The precise structure will depend on what is most appropriate, depending on individual circumstances.

PROTECTORS AND OTHER NON-FIDUCIARY POSITIONS

For additional control, the Trust Instrument may cater for the appointment of a Protector. The Protector (who could be an individual, or perhaps, a ‘Committee’ made up of representatives from different branches of the family) can be given a variety of powers, such as the ability to replace the trustee or the ability to appoint an Investment Adviser.

The exercise of some of the trustee’s powers can also be made subject to the consent of the Protector. For instance, the Protector may have to consent to all capital distributions. The Trust Instrument may also specify that specific functions are carried out by particular people.

A Purpose Trust (which has no beneficiaries) will usually require the appointment of an Enforcer whose role would be to ensure that the purposes of the trust are adhered to.

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