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Onshore UAE Trusts Law – Refresher and Overview

By James Bowden | 28 March 2021

UAE Federal Decree Law 19 of 2020 Regarding Trusts (the UAE Trusts Law) was issued in September of 2020. As there was no comparable law previously, the UAE Trusts Law opened the door to trusts in the UAE for the first time (not including DIFC and ADGM trusts, the UAE's two financial free zones). This is a potentially significant development that holds great promise, although some key questions remain.

Trusts and Some Examples

In short, a trust is an arrangement whereby a third party (trustee) is entrusted with assets given over by a person who establishes the trust (settlor or contributor) for the trustee to manage and distribute for the benefit of specified beneficiaries (or sometimes specified purposes). The settlor transfers legal ownership and (usually) control of the trust assets, which are legally owned and controlled by the trustee, subject only to the trustee's duties at law, and duties under the trust instrument. The concept of trusts was developed by the English common law, although similar divisions of legal and beneficial ownership have long existed in the civil law world as well (civil law foundations being a well-known example).

Trusts can be a useful tool in business structures, as an investment vehicle, as a tool in estate/wealth planning for both tax and non-tax reasons, as an asset protection tool (from creditors or other third parties), and as a succession tool upon a person's death, among many other uses. A few words about each of the above may be in order:

1. Business structures: trusts are used for many different reasons in business structures. Examples include ensuring continuity of ownership without disruption on succession; using trusts as a form of security in lending transactions to bypass local security registration mechanics; or simply a convenient and permanent method of managing divided rights among beneficiaries

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(beneficiaries instead of shareholders), as there may also be some significant advantages in terms of privacy.

2. Investment vehicle: a trust is a popular vehicle through which to solicit investment from third parties for the purpose of acquiring and managing underlying investments, whether in the form of real property, active businesses, or passive investments. The advantage of using a trust structure instead of a conventional corporate structure is largely tax driven, but there are other potential advantages in terms of the ability to manage rights of "unit" holders as opposed to the rights of shareholders (i.e., you can often limit their rights further). The UAE Trusts Law specifically contemplates the use of UAE trusts for this purpose. Note that the UAE's laws regulating solicitation of investment from third parties should be assumed to apply as usual, whether or not the investment is structured as a trust (the UAE's securities regulator, the Securities and Commodities Authority, has not commented on the UAE Trusts Law as of the date of writing, to our knowledge).

3. Estate/Wealth Planning: this is perhaps what trusts are best known for. Trusts can be invaluable tools for both tax and non-tax reasons in a person's estate planning, both during life and after death. Income sheltering, income splitting, avoidance of probate, avoidance of estate administration burdens and delays, and control over one's legacy are all common goals with trust-based planning. As a zero-income-tax jurisdiction, the UAE may begin to compete among the conventional low or no tax jurisdictions for the creation of trust-driven estate planning structures. Foreign assets, from foreign settlors, for the benefit of foreign beneficiaries, are all permissible under the UAE Trusts Law.

4. Asset protection: since the assets transferred to a trust are no longer the legal property of the settlor, creditors of the settlor cannot attach or recover them. Creditors can still attach and recover a beneficiary's interest in the trust if and to the extent it is vested. This is addressed by granting trustees discretion as to the timing and amount of any distribution to any beneficiary, so that beneficiaries do not actually have any vested entitlement (and therefore nothing to attach or recover) unless and until the trustees resolve to make a distribution to any given beneficiary. The UAE Trusts Law contains provisions that specifically contemplate and support the use of UAE trusts for this purpose. Note that a disposition of assets into a trust on the eve of insolvency or to deliberately prejudice a particular creditor will not be effective as the UAE's insolvency law permits recovery of assets disposed of up to two years prior to the date insolvency proceedings are commenced under that law[1].

As mentioned, the above list is indicative only and by no means exhaustive. Trusts are vehicles which, by their nature, allow for a great deal of creativity and flexibility, and particularly so in a zero-income-tax jurisdiction like the UAE.

UAE Trusts Law – Selective Overview

The UAE Trusts Law contains several provisions that will be familiar to trusts and estates practitioners in common law jurisdictions, such as the duties of a trustee to "preserve" the trust assets, and to manage the assets and make distributions in a manner that is "neutral between the beneficiaries" (even hand rule). How these and other provisions of the law, upon which there is an enormous quantity of jurisprudence in the common law world, will be applied and enforced by UAE courts remains to be seen.

The role of the trustee should not be taken on lightly, as the role comes with many duties and many possible sources of liability. Professional advice is essential for anyone considering acting as a trustee in the UAE. Individual trustees can be appointed without any particular qualifications, but corporate trustees must be licensed to provide trustee services (details of this licensing requirement are to follow). The duties of a trustee under the law, however, apply equally to all trustees, whether professional service providers or inexperienced individuals. While professional trustees will find the compliance burden imposed by the UAE to be light compared to many other jurisdictions (as so much of a trustee's administrative burden and liability can relate to tax compliance, which is not a concern in the UAE), the duties are still a significant burden for the uninitiated

[1] Articles 168 and 169 of the UAE Insolvency Law

and include regular report preparation, careful record keeping, asset management and supervision, interpreting and applying the terms of the trust instrument, knowing the law and key accounting principles around management and distribution of the trust assets, and appropriately documenting all actions taken as trustee. Failings can expose the trustee to liability, the source of which is not always obvious.

The UAE Trusts Law places a great deal of importance on the trust instrument itself, which is entirely appropriate. The trust instrument is the written document that establishes the trust and sets out its terms. It is very important to craft the terms carefully and thoughtfully, and with a view to several specific provisions of the law which allows for certain outcomes only if the trust instruments include certain language. For instance, the trust instrument should specifically empower a trustee to appoint auditors or else the settlor will have to amend the trust instrument or the trustee will have to make an application to the court; or, a trustee can only obtain a discharge of liability from the beneficiaries if this is contemplated in the trust instrument. The New Trusts Law contains several other similar “if/then” consequences, and careful drafting is therefore critical. If there are any foreign settlors or beneficiaries (very likely to be the case in a cosmopolitan jurisdiction like the UAE), it may be that specific drafting will be required to avoid unintended tax consequences in other jurisdictions as well (such as attribution rules that attribute assets or income back to an individual if they retain certain interests or control over trust property or governance, for example).

Note that a UAE trust will not exist until it is registered with the UAE Ministry of Finance, in a registry to be created for the purpose. The creation of, and rules governing, the register is one of the issues that will be addressed by the Cabinet Decision. While full disclosure of the identity of the settlor(s), trustee(s), protector(s) and beneficiary(ies) will be required, what this means in terms of specific submissions required remains a key question mark (ID copies? Proof of address? Proof of tax residency? CRS-style questionnaires? Ongoing reporting on a periodic basis?). This registration requirement differs from DIFC or ADGM trusts (and the common law world at large), and could act as a disincentive for the use of onshore UAE trusts given the reluctance of settlors to file potentially sensitive, personal details contained in trust instruments with a government body.

Finally, I will note that the New Trusts Law provides that UAE trusts are legal entities with their own legal personality, which is not the case with common law trusts. This means the trust itself, not the trustee, will have legal ownership of the trust property. While this is conceptually a major difference between common law trusts and a UAE trust, the practical implications of this will be relatively minimal. The trustee still carries liability for its failures, just as with a common law trust. One advantage may be that it will make the replacement of trustees easier, since ownership of property need not change hands.

Foreign Tax Considerations

Many high-tax jurisdictions apply “deemed residency” rules to foreign trusts where the foreign trust has connections to that jurisdiction, such as where there is a settlor that is a resident of the high-tax jurisdiction. In such cases, a UAE trust could be deemed tax resident in another country and made liable for payment of tax, as well as reporting and filing obligations in that other jurisdiction. Such laws tend to make the foreign trustee jointly liable with other parties (such as the settlor or beneficiaries that may be resident in the other country). Even if the tax authority collects from such other parties, joint liability means that the other parties may then be able to claim against the trustee for compensation.

Also, as a general matter, citizens and residents of other countries should be aware that a UAE trust could be “deemed resident” for tax purposes in that other country on the basis of there being a settlor, beneficiary, trustee, or on some other grounds.

The importance of professional advice cannot be overstated as dealings with trusts can be quite complex.

Conclusion

There are some questions that remain to be answered about the new regime and its practical implementation, many of which should be addressed in a Cabinet decision by which the UAE Trusts Law contemplates will follow, which will set out some further implementing rules (the **Cabinet Decision**). Among other things, the Cabinet Decision is expected to address:

- The creation of, and rules applicable to, the trusts register;
- how a trustee can become licensed to provide trustee services;
- additional clarity on trustee duties; and
- special provisions around charitable trusts, pension trusts, and investment trusts.

We will provide a further update once the Cabinet Decision is issued.

Note that many of the benefits, and accompanying risks, which are noted above apply equally to DIFC, ADGM and RAK foundations, and to DIFC and ADGM trusts. The question will be, in practice: what advantages, if any, does the UAE Trusts Law regime offer to distinguish itself from the DIFC, ADGM and RAK? The uses for DIFC, ADGM and RAK foundations to date has tended to be limited to holding UAE-based assets. If the UAE can establish itself among the traditional "offshore" financial structuring hubs by attracting foreign assets as well, the UAE stands to benefit greatly from the influx of capital, investment, and the growth of the professional service community that surrounds such activity (trustees, agents, investment managers, advisors). ■