

Radical DIFC reforms update trust law and extend wealth planning options

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Abstract

The Dubai International Financial Centre ('DIFC') is a special zone within Dubai, with its own common law jurisdiction. It remains an integral part of Dubai. The DIFC Courts are part not only of the Dubai Courts but also of the federal United Arab Emirates ('UAE') judicial system.

On 21 March 2018, the DIFC enacted the Trust Law No 4 of 2018 ('the Trust Law'). This superseded the Trust Law No 11 2005. One of its primary aims is to bring DIFC Trust Law in line with international best practice. While many of the changes draw on developments from a number of trust jurisdictions, the main provisions follow the US Uniform Trust Code ('UTC'). The Trust Law contains updated provisions on quite a number of different issues, including those covered by this article.

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Removal of English law link

Article 10(2) removes a major link to English law by providing that English statute law applicable to trusts will not, except as replicated in the Trust Law, apply in the Dubai International Financial Centre (DIFC). This follows from the primary source of the Trust Law being the Uniform Trust Code (UTC).

Legislation tightens 'firewall' provisions

There are considerable changes to the legislation to tighten up the 'firewall' provisions. This is intended to protect trusts from the effect of foreign judgments. These may

otherwise have impacted the trust's validity, effectiveness, or administration. The relevant provisions are contained in Articles 11–16.

Articles 13 and 14 clarify the matters determined by the governing law and place additional limitations on the applicability of foreign law, respectively. Article 14(1), *inter alia*, disregards any reference to a foreign law relating to the settlor's capacity. In addition, Article 14(2) provides that a transfer of property to a trust shall not be void, voidable, or liable to be set aside by reason of a settlor's bankruptcy or any creditor's claims against the settlor.

Article 14(3) provides that, notwithstanding this, if the settlor was insolvent or intended to defraud any creditor of the settlor, the court may declare that the transfer of property was void to the extent of the creditor's claim. As with asset protection legislation in jurisdictions such as the Cook Islands, the burden of proof is placed on the creditor to show that the settlor was insolvent, or that the intention was to defraud any creditor.

It is not difficult to imagine that where Dubai residents involved in highly speculative business ventures use DIFC trusts to protect against potential claims from other Dubai residents, or UAE nationals, generally such aggrieved creditors would be likely to choose to issue proceedings in the Dubai Court or UAE Court, rather than the DIFC.

In view of the tough line taken on many issues surrounding bankruptcy by Islamic Courts in the region, the use of DIFC trusts as a vehicle for asset protection against local creditors would seem likely to become, sooner or later, a major source of friction, particularly on the extent to which the UAE/Dubai Islamic Courts should have primacy to handle such issues involving creditor's claims, to recover assets settled in a DIFC trust, where the settlor subsequently becomes insolvent.

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Article 15 restricts the applicability of forced heirship rights, while Article 16 provides that foreign judgments shall not be recognized or enforced, in so far as these are inconsistent with Articles 14 and 15.

Hastings-Bass principle enshrined in law

Articles 22–29 outline powers given to the court to address the consequences of mistake. Articles 25 and 27 broadly enact the principles arising from the decision *Re: Hastings-Bass* (1974) EWCA13. Articles 24 and 26 sidestep the decision in *Pitt v Holt* (2013) UKSC26 in relation to the availability of rescission as a remedy for mistake.

Statutory right to arbitrate trust disputes

Articles 30–32 and Schedule 2 create a statutory right to arbitration to resolve trust disputes, where consistent with the trust instrument. These give the court the power to refer such disputes to arbitration, should any party so require.

Trusts contrary to DIFC public policy are invalid

Article 9(2)(c) provides that the terms of a trust prevail provided that the trust has a

purpose that is lawful and is not contrary to DIFC public policy. Article 35(1) provides that a trust may only be created to the extent that its purposes are certain, lawful, and not contrary to DIFC public policy. Article 37(2)(b) provides that a trust shall be invalid to the extent to which the trust is immoral or contrary to DIFC public policy.

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Various ancillary provisions

Article 36 provides that a trust may continue indefinitely, and no rule against perpetuities or excessive accumulations shall apply to a trust or to any advancement or appointment thereto. Articles 38 and 39 outline provisions relating to the enforcement of charitable and purpose trusts. Article 40 outlines provisions relating to the variation or revocation of trusts. Article 41 gives power for the court to authorize dealings with trust property. Article 48 sets out the potentially severe consequences for a beneficiary who challenges the status of a trust, or who declines to co-operate in arbitrating a trust dispute. Articles 57 and 58 set out provisions for appointing advisory and custodian trustees.

Liability of trustees

Article 77(1) provides that a person may not commence proceedings against a trustee for breach of trust for more than 3 years after the date such person receives a trustee report that adequately discloses information that could form the basis for a potential breach of trust claim and informs such person of the time allowed for commencing proceedings.

Article 77(2) states that if sufficient information is provided that such person knows, or should have inquired into its existence, the report adequately discloses the existence of a potential claim. Subject to Article 77(1), Article 77(3) provides that, except in cases of fraud, proceedings should be commenced within 7 years of the removal, resignation, or death of the trustee, the termination of the beneficiary's interest in the trust, or the termination of the trust, as the case may be. In case of fraud or proceedings to recover trust property from

the trustee, there is no limitation period.

Article 81(1) provides that if the trustee in a contract disclosed its fiduciary capacity, then the trustee would not be personally liable on a contract properly entered into in the course of administering the trust. However, Article 82(2) confirms that only in the case that the trustee is personally at fault, should such trustee be personally liable for torts committed while administering the trust, or for obligations arising from ownership or control of trust property.

Incapacity issues

Article 85 outlines provisions relating to the incapacity of the protector or the settlor. There must be concern about some of the wording in this article. For example, Article 85(1) provides that settlor's powers should pass to the protector on the settlor's incapacity. That may well cause headaches in many cases, where the settlor may wish his powers (or some of them) to cease on his incapacity, rather than passing to the protector.

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In so far as that function is determined as being within the rights and powers of the settlor, this also seems to imply that the protector might have the ability to issue fresh letters of wishes after the settlor's incapacity.

If it is necessary to have a provision of this nature, eg because of the political instability in the settlor's home jurisdiction, then a better formula may be to make any provision of this nature subject to the consent of an independent third party appointed for this purpose under the terms of the trust such as a protector or guardian as a means of ensuring the necessary checks and balances for the trust's effective governance.

In addition, there must be some concern about the wording of Article 85(4). This seems to give the trustee the power to declare any person (including the settlor) as incapacitated, on the grounds that the trustee thinks that the person is unable to freely exercise his rights or powers, or to fulfil his duties or obligations because of duress or undue influence brought to bear on such person. However, curiously, it provides that that trustee shall not be under any duty to make any inquiries whether such person is actually subject to such conditions.

As the trustee is not under any duty to make any inquiries to establish the true position before acting to deprive the settlor or any other person of their powers, the unfettered nature of this provision may give rise to some concern. This opens up the unfortunate possibility of a person, such as the settlor, being effectively deprived of his powers on the basis of an unsubstantiated rumour.

Enlarged role of the Trust Law in wealth succession

Stepping aside from the detail of the legislation, it is worthwhile to consider who may wish to set up such DIFC settlements, and the property which may be settled. In the context of succession planning, Middle East residents may be particularly attracted to setting up DIFC Trusts with onshore or offshore assets.

A Gulf Family Business Council report estimated that nearly 90 per cent of the Gulf business is family owned. This collectively contributes 50–60 per cent of the aggregate regional Gross Domestic Product. Of these businesses, around 70 per cent may experience generational change of ownership control over the coming decade. Without taking account of the offshore assets, this report highlights that about US\$1 trillion is due to transition generations in the next 10 years.

With the serious risks of wealth being frittered away through family disputes, or otherwise being dissipated through unwise life styles or imprudent investments, this immense flow places the DIFC with its modern Trust Law in pole position to assist in helping structure this generational wealth transition in the region in the forthcoming period.

Around 85–90 per cent of Dubai residents are foreign nationals. Many of these have created successful businesses. In so far as the inheritance law to which particular foreign nationals may be subject to is not Islamic law, the Trust Law may provide an ideal platform for wealth succession planning.

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More care may be needed where the settlor is subject to Islamic inheritance law, particularly consideration of whether any conflict of law issues may arise where a UAE national wishes to set up a DIFC trust, with the intention of circumventing UAE inheritance law, which would otherwise stipulate the fixed Shari'a law fractions to be applied on his passing.

Although in most cases, this may not give rise to difficulty, it would be wise for any Islamic settlors to obtain the requisite advice in their jurisdiction that no potential conflict of laws, issues may arise. To take simple examples, first, what are the consequences for a UAE national setting up a settlement over which he reserves a power of revocation, and that settlement excludes one or more of his forced heirs (*'Faraid Heirs'*) under the UAE law, or where the settlor wishes the trust property to devolve in fractions which disadvantage one or more of the *Faraid Heirs*?

As a second example, what would the position be where a UAE national in his final illness (*'mard al maut'*) gifts the greater part of his wealth for the benefit of some *Faraid Heirs*, but excludes others and he then dies? Would that be a potential breach of UAE law requiring any gifts in such final illness to be clawed back into his estate? This difficulty arises because a settlor, in his final illness, may be treated as lacking capacity under UAE law to carry out transactions of this nature.

Would these two examples be seen as contrary to public policy on the grounds that the UAE national has attempted to use a DIFC trust to sidestep the strict provisions of UAE inheritance law? If that were the case, might an aggrieved *Faraid Heir* seek to argue that Articles 9(2)(c), 35(1), or 37(2)(b) of the Trust Law (which all make reference to trusts only being created to the extent that their purposes are lawful and not contrary to public policy in the DIFC), would be interpreted as intended to protect the integrity of UAE Islamic inheritance law? If so, then any aggrieved party may apply either to the DIFC Court to disallow DIFC transactions intended to circumvent UAE public policy, or apply instead to the UAE Court on similar public policy grounds. Alternatively, would the provision in Article 14(1), which directs the DIFC Court to disregard any foreign law relating to the settlor's

capacity, be effective to override any Dubai/UAE Islamic Court concerns about the public policy primacy of Islamic inheritance law?

On 9 June 2016, the Ruler of Dubai issued Decree No19 of 2016 ('the Decree'). The Decree established a Dubai–DIFC Judicial Committee ('the Judicial Tribunal'). This outlined that the Judicial Tribunal would be responsible for resolving jurisdictional disputes and conflicts of judgments between Dubai and the DIFC Courts. The Dubai judges constitute the majority of the Judicial Tribunal, with the DIFC judges being in the minority. This set out a procedure to be adopted for the resolution of such jurisdiction conflicts.

In the context of such inter-jurisdictional disputes, it is worth noting the ongoing litigation in the DIFC and Dubai Courts over repossession of the yacht *MV Luna* arising from the divorce case of *Akhmedova v Akhmedov* [2018] EWFC 23 Fam in the English High Court.

Put simply, Mrs A, in the course of her English divorce litigation applied to the DIFC for a freezing order against Mr A and the Liechtenstein Anstalt which owned *MV Luna*. This order was granted and upheld on appeal by the DIFC Court of Appeal. Thereafter, Mrs A applied to the Dubai Islamic Court for a precautionary attachment. This was granted. Mr A then filed a claim that his dispute was a matrimonial one, rather than a commercial debt. Consequently, he argued that it should be determined by the Dubai Islamic Court. The Court dismissed Mrs A's application for possession. This highlights that jurisdictional DIFC/Dubai parallel litigation may have different outcomes.

No doubt this potential dispute between rival Dubai jurisdictions will be resolved. Nevertheless, it is a cogent case study of how competing litigants may select different Dubai Courts for specific issues in disputes. At first sight that aspect may remain a particular risk for anyone subject to Islamic inheritance laws seeking to circumvent Islamic inheritance laws policy, or anyone seeking to use the Trust Law to disadvantage their creditors contrary to public policy and flags up the need for settlors to obtain careful advice on such material legal consequences.

Subject to these minor points, this new state of the art legislation should place the DIFC in a much better position to address the growing need for tailored wealth succession solutions in the region.

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