

## Article

# Building better foundations: the Dubai International Financial Centre foundation law consultation

Shabana Saleem\* and Mihaela Cornelia Moldoveanu†

### Abstract

The current proposed amendments to the Dubai International Financial Centre (DIFC) Foundations Law No 3 of 2018 (consolidated version of 2022) (“Foundations Law”) come at an opportune time and are testament to the wider progressive measures taken by the DIFC legislator, and to the growing popularity of foundations. The DIFC consultation paper introduces specific amendments to enhance this legislation. If implemented, the amended law will help meet the needs of the ever-growing private client base that increasingly uses foundations as a preferred structuring and succession-planning option. This article focuses on the key tenets of the DIFC consultation paper’s proposed amendments to the Foundation Law.

‘firewall’ asset protection provisions, the doctrine of mistake and the Hastings-Bass rule, and the conversion of a company into a foundation. [...] To this effect, it is worth noting that the ‘torch’ of jurisprudential creativity and vision. . . has been passed on in our times to the drafters of the DIFC Foundations Law 2017.<sup>1</sup>

The Foundations Law set itself the ambitious task of establishing a much-needed legal framework to improve the management of the considerable wealth in the region by means of foundations, which cater to both Muslim and non-Muslim clients. As “orphan” legal structures (without shareholders), foundations derive their origins in the civil law context and are used by private clients and businesses alike, for both charitable and non-charitable purposes. Foundations have the potential to capture the needs of the traditional family and of the modern corporation, pension fund and/or managed investment.

The Foundations Law came into effect in March 2018 “paving the way for private clients to safely structure their local assets within the leading financial hub for the Middle East, Africa and South Asia to offer a truly first class wealth planning solution”.<sup>2</sup> The Foundations Law is unlike comparable regimes

### Introduction

The DIFC legislation builds upon the legislative experience of the first two decades of this century. . . (reflecting) . . . the main features of common law foundations as well as some aspects of the Dutch stichting. It contains some unique features, such as

\*Shabana Saleem, International Private Client Law Barrister, Outer Temple Chambers, 222 Strand, Temple, London WC2R 1BA, UK. Tel: 020 7353 6381; Email: Shabana.saleem@outertemple.com

†Mihaela Cornelia Moldoveanu, Hourani & Partners, The Offices 5, 3<sup>rd</sup> floor, One Central, Dubai World Trade Centre. P.O. Box 554660, Dubai, UAE. Tel: +971 507399320; Email: ellam@houranipartners.com

1. Panico, P. ‘The DIFC Foundations Law 2017’, Oxford Academic Trusts & Trustees Journal, Volume 23, Issue 10, December 2017, Pages 1051–1065.

in the region as the legislative framework affords the vehicle relatively more latitude to appeal to a wider market. For example, the Foundations Law allows:

- a. a company to be converted into a foundation and a foundation may, if so desired, have either exclusively charitable or non-charitable purposes, or both;
- b. the recognition of a foundation as separate from corporations, to allow for the distinct tax treatment of foundations;
- c. a foundation to act as a trustee of a trust;
- d. enhanced firewall provisions limiting the impact of potential actions taken by foreign authorities or foreign courts;
- e. uncomplicated migration (inbound and outbound) into other jurisdictions;
- f. straightforward division or amalgamation; and
- g. easy conversion of a foundation into a different legal form (if necessary).

This article considers the Dubai International Financial Centre (DIFC) consultation paper's proposed amendments to spotlight the key Foundations Law provision that will shape the future use of this structuring option.

## Giving creditors their due?

The current Foundations Law addresses the potential claims of creditors with limited provisions which allow creditors the following rights:

- apply for the removal of a Foundation from the DIFC Register<sup>3</sup>;
- prevent the Foundation from leaving the DIFC if this would adversely impact a creditor<sup>4</sup>;

- apply to the competent court, being the DIFC Courts, for the dissolution of a Foundation<sup>5</sup>; and
- allow the application of the DIFC Insolvency Law in respect of creditors' rights in the event of winding up of an insolvent Foundation, with a similar treatment applicable to foundations as to insolvent companies.<sup>6</sup>

The DIFC Courts (the 'Court') were permitted to give creditors of a Founder or a Contributor of a Foundation legal remedy to seek recovery of property transferred to a foundation, in the event that at the time of transfer, the Founder or a Contributor was insolvent or intended to defraud a creditor. The Court could declare the property transfer void. The addition of Article 14(3) introduces additional safeguards whilst also reversing its position on rendering a transfer void or voidable. It applies a higher burdens of proof threshold, in that creditors must satisfy the Court that:

- a. at the time when the property was transferred to the Foundation, the Founder or Contributor, as applicable, intended to defraud the creditor and
- b. at the time the transfer took place the transfer of the property "rendered the Founder or Contributor, as applicable, insolvent or without property from which if that creditor's claim had been successful, it could have been satisfied".<sup>7</sup>

If the court is satisfied of the intent to defraud and the creditor's claim, the Court shall declare the foundation liable to satisfy the creditor's claim, but only to the extent of the interest of the Founder or Contributor in the property prior to the transfer. The proposed addition of Article 14(4) ensures that the creditor's claim shall be limited to the recovery of the property referenced with in Article 14(3).

2. Equiom Fiduciary Services (Middle East) Limited, 'A private client's guide to DIFC Foundations', 14 May 2020, Retrieved online from: <https://www.equiomgroup.com/news/private-clients-guide-difc-foundations#:~:text=Foundations%20are%20often%20used%20to,or%20incidental%20to%2C%20its%20objects.>

3. Article 58 of the Foundations Law.

4. Article 59(b) of the Foundations Law.

5. Article 68 of the Foundations Law.

6. Article 70(1) of the Foundations Law.

7. The Foundation is also required to "be liable to satisfy the creditor's claim and the Foundation's liability shall only be to the extent of the interest the Founder or Contributor, as applicable, had in the property prior to the transfer and of any accumulation to the property transferred (if any) subsequent thereto".

The proposed amendment should enable the Court to address the influx of significant wealth, particularly given the likelihood that creditors may follow suit in the region. It is possible that creditors (such as former spouses with claims over the marital property) with foreign judgments may find it more onerous to rely on Article 14 to recover property settled into a DIFC Foundation. However, this article must also be considered alongside the reality that creditors with extra-jurisdictional claims may well continue to face other types of enforcement challenges in the region.

### One sword but two shields?

The application of the proposed Article 14 must be viewed alongside the proposed amendments to the treatment of foreign judgments in Article 16 and the new duress provisions introduced in Article 26A of the Foundations Law.

First, the proposed amendments to Article 16 (Foreign Judgments) enshrine the supremacy of DIFC law, as follows:

- I. Article 16(1) expands the application of the prohibition to recognise or enforce a foreign judgment if it is inconsistent with, *inter alia*, Article 13 (Matters determined by DIFC law), thereby reinforcing the position that specific foundation matters must be determined solely by DIFC law in the DIFC Court.
- II. Article 16(2) provides that no proceedings for, or in relation to, the enforcement or recognition of a judgment obtained in a foreign jurisdiction in respect of a person connected to, or of a property of, a DIFC foundation,<sup>8</sup> shall be entertained by the DIFC if that foreign “judgment is based upon the application of any law inconsistent with the provisions of” the Foundations Law. For example, if a creditor relies on Article 14 seeking to enforce a foreign judgment, that judgment shall not be

recognised or enforced if that judgment is contrary to the Foundations Law. This amendment underpins the firewall provisions in accordance with the DIFC standards, strengthens the Courts’ exclusive jurisdiction in respect of DIFC foundation matters, and provides comfort to founders, contributors and beneficiaries alike, that they are not exposed abroad (for example, in respect of foreign heirship rights).

- III. The proposed Article 16A explicitly asserts the DIFC protective jurisdiction over the foundation, and over its guardian or council member, by requiring that any guardian or council member immediately upon the action of a foreign court or tribunal cease acting in “all respects” of in acting or having authority over the Foundation. This amendment logically compliments the amendments in Article 16(1) and 16(2) and strengthens the firewall provisions, by insulating the foundation from foreign court orders that may compel a guardian or council member to take action or exercise power, which affects or will affect the Foundation or any interest in the property of the Foundation.

Secondly, the introduction of the new Article 26A provision strengthens the protection afforded to the Foundation by classifying actions directed pursuant to ‘legal process, directive, order, or like decree of any court (other than the Court), administrative body or tribunal or like authority’ as duress. The key stakeholders<sup>9</sup> are directed (insofar as each person is not subject to personal liability or exposure) to ignore any demands or requests. This amendment is key as it enhances the protective provisions contained in the Foundations Law, limiting the impact of any potential action by external authorities or foreign court orders. It aims to ensure that a DIFC foundation’s status remains unchallengeable to the widest extent possible, protecting this structure from potential adverse events (such as

8. Specifically, against a DIFC Foundation, Founder or Contributor of a DIFC Foundation, member of the Council of a DIFC Foundation, Guardian of a DIFC Foundation, Qualified Recipient of a DIFC Foundation, a person appointed or instructed in accordance with the express or implied provisions of an instrument or disposition to exercise a function or undertake any act, matter or thing in connection with a DIFC Foundation or property of a DIFC Foundation.

9. Founder, Contributor, Council member, Qualified recipient, Guardian or other persons with authority.

political events or changes in legislation habitually governing the DIFC foundation's connected persons or property).

The carefully crafted proposed amendments to Articles 16 and 26A will no doubt impact the attractiveness of DIFC foundations. A creditor, foreign authority or other persons with an interest in the foundation and/or its property may well have a sword to attack the foundation by, for example, seeking enforcement of a foreign court order; however, the foundation has been given two shields to protect against such attack and to re-direct any such claim in respect of the foundation, to the competent court, being the DIFC Court, which will make its determination based on the DIFC law. The sword-and-shield nature of these proposed amendments will provide greater credibility to DIFC foundations and contain any residual concerns in respect of the enforcement of foreign judgments such as heirship rights. This is a welcome development, in keeping with other leading common law wealth structuring jurisdictions.

## Foundations in the age of transparency

Article 34 refers to the functions of the DIFC Registrar (the 'Registrar'), in relation to a DIFC Foundation. The proposed amendments to this article appear to align the Foundations Law with the recently enacted DIFC Family Arrangements Regulations. It establishes the rules for the interaction between the Registrar and the DIFC-licensed corporate service providers (CSP), who act on behalf of the founder or the foundation as their client. Specifically, the article allows CSPs to lodge any related documents and pay any fees, on behalf of a DIFC Foundation, directly with the Registrar. It also imposes a duty onto CSPs to:

- a. conduct verifications to satisfy the DIFC (and the UAE federal authorities) anti-money laundering (AML) regulations, the ultimate beneficial owner

(UBO) regulations and other associated requirements; and

- b. maintain a foundation's accounting records and provide certifications in this regard.

The Registrar, in good faith, may rely on the CSP certification without further enquiry. However, if the Registrar finds that a CSP acted in breach of its agreed obligations, it may revoke the CSP's rights, inform the regulatory authority<sup>10</sup> of any facts or circumstances that may amount to a breach of a CSP's regulatory duties under applicable law, and potentially notify law enforcement authorities of any alleged or suspected criminal offences on the part of a CSP or its clients.

The reference to the CSP's duty to conduct the requisite verifications in relation to AML, UBO and other associated requirements of the DIFC Registrar seeks to deliver a clear message that the establishment and continuation of a DIFC Foundation shall always be subject to compliance with the DIFC (and, by extension, with the UAE federal level) regulatory framework. The UAE government has, in recent years, introduced legislation and provided a high-level political commitment to align itself with the international transparency agenda and with FATF<sup>11</sup> recommendations.

## Conflicts beware

The consultation's proposed amendments to Article 50 deal with facilitating Foundation division or amalgamation with a view to reducing the likelihood of litigation.

The default position of Article 50 provides for the division and amalgamation of DIFC foundations. Intra-family or intra-council disputes may result in the necessity for a foundation to be divided if a collaborative approach to the foundation's objectives is no longer attainable. Instead of winding up or dissolving the foundation entirely, the decision makers may opt to divide the foundation and split the subject assets between the existing and newly formed foundation. Tax

10. The Dubai Financial Services Authority (DFSA).

11. FATF is the Financial Action Task Force, the global money laundering and terrorist financing watchdog.

or governance considerations may also be at the origin of a foundation's division. Similarly, several connected foundations (e.g. by way of having the same founder or objectives) can be combined to maximise the synergies and/or economies of scale to streamline governance and/or financial efficiency.

The proposed amendments address resolving any potential disputes. In circumstances where the disputing parties are unable to effectively govern without external assistance, the proposed amendments in Article 50(3) provide the Courts with a supervisory role to effect the division or amalgamation. The Court may decide on:

- a. the establishment of a new foundation;
- b. appointments of council members for each of the foundations;
- c. whether the existing members of the Council shall continue to act as members of one or more foundations' councils; and
- d. whether the existing Foundation will continue in accordance with its existing Charter and By-laws and the other Foundation(s) will be established with similar or different Charter(s) or By-laws approved by the Court.

The proposed Article 50(7) seeks to direct the division of a Foundation's property on a fractional basis and guide the transfer either within a pro-rata portion or within on a non-*pro-rata* basis (based on either the fair market value or on valuation of such property).

The proposed Article 50(5) clarifies the separate legal standing of a new foundation that is created by virtue of Article 50 (i.e. by division or amalgamation), including, but not limited to any and all issues related to the liability of the new Foundation or the property of the new Foundation pursuant to a contract, in tort or otherwise.

The proposed Article 50(4) requires the Court, when administering the property of any separate Foundation (in the event of amalgamation or division), to consider the potential impacts on the tax treatment of a foundation's property. The default position under the law, in line with common law approach, allows a foundation's council the discretion to formulate their own process

for amalgamation or dividing foundations but the proposed amendments will grant the Court authority to rule on any matters that a Foundations' council is unable to agree on.

The proposed Article 53A introduces a statute of limitations on any actions with the aim to (a) set aside the establishment of a Foundation or (b) to set aside any disposition to any Foundation or (c) for any order under Part 7 of the Foundations Law, to a period not exceeding 3 years from either (i) the date of the establishment of the Foundation that is sought to be set aside; (ii) the disposition to the Foundation that is sought to be set aside; or (iii) the right to commence the action or proceeding. The same 3 years statutory limitation also applies in respect of action against a property a property transferred into a foundation, from the date that the property was disposed to a foundation.

The proposed amendments relating to dividing or amalgamating foundations seek to address the potential paralysis of the foundation's inability to determine key issues. It is hoped the proposed amendments will enshrine the default position within the Foundations Law, thereby reducing the time and expense of litigation to determine these issues. The consultation should effectively give notice to Foundations to be wary of any in-decision, given the likelihood that such matters may be resolved via costly court proceedings.

## Conclusion

The road ahead, however, is paved with familiar challenges for the DIFC. The DIFC will continue to innovate but it will need to carefully consider how to maintain the delicate balance between privacy and transparency. The recently enacted DIFC 'Family Arrangements Regulations 2023', introduced provisions that allow DIFC foundations to be deleted from the DIFC public (online) register and be transferred onto a DIFC private register. The DIFC offers a high level of security of information protection within its legislation, whilst ensuring compliance with AML/CTF and tax transparency regulations.

Overall, the proposed amendments attempt to improve the DIFC foundations framework by addressing the thorny issue of creditors and fending off the impact of any foreign jurisdictions. The DIFC's commitment to innovate and expand its wealth management regime is an indicator of the acute need for better structuring governance and management of wealth in the United Arab Emirates and the wider region.

In short, however, the higher degree of latitude and protection afforded to the foundations relative to other jurisdictions, make the DIFC foundations an attractive option in the international stage of asset management. Any legislative reform must consider the best means of providing flexibility and legal

certainty to minimise litigation. The consultation paper's proposed amendments are remarkably clear and shed light on areas of potential uncertainty. The adaptable and flexible nature of the Foundations Law may create uncertainty about potential DIFC Court outcomes, for example, the DIFC approach to any creditor claims and/or addressing inaction as a result of individuals ceasing to act for the foundation due to foreign court proceedings. The proposed amendments should, nonetheless, reassure stakeholders that the DIFC foundation is fiercely protective of subject assets and it will continue to innovate to remain at the forefront of international best practice.

***Shabana Saleem** is a barrister (England and Wales) practicing at Outer Temple Chambers. She is an advocate with experience in international private client family matters, particularly involving trusts. She has acted in High Court proceedings and has expertise on the English law treatment of Shari'a.*

***Mihaela Cornelia Moldoveanu** is a policy, governance and legislative drafting expert, with 16 years of experience in public and private sector organisations. She has overseen the establishment of the DIFC Wills and Probate Registry in Dubai and consulted on a common law commercial court and arbitration centre in Kazakhstan.*