The UAE’s onshore Trust Law

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Introduction

The enactment of the UAE’s 2020 Trust Law is a significant development in the scope of trust jurisprudence in the UAE. By introducing Anglo-American trust arrangements into the UAE’s civil legal environment, the UAE legislature has reformed the concept of beneficial property interests in a manner that is essentially alien to the civil law.

Internationally trust arrangements, in Anglo- American legal systems, have evolved in importance over the years and have come to underpin many of the key structures and concepts that support and provide for international business and wealth management.

The new UAE Trust Law, for the first time, grants full recognition to similar trust arrangements – but within an onshore UAE legal system derived from the Egyptian civil code, not a system shaped by Anglo-American jurisprudence. In this way, the UAE Trust Law is wholly different to trust laws of the financial free zones in the UAE that have imported and transplanted the common law legal system.

Why the UAE needs an onshore Trust Law

Over the past three decades the UAE economy has increasingly been exposed to, and integrated with, sophisticated international business and financial practices and markets. Many UAE residents have been exposed to the sophisticated legal products which are underpinned by trust arrangements.

As a consequence, there is an appetite in the UAE market for these legal products. They range from private family trusts to publicly traded mutual funds and securitisation structures. Although these legal products are available in the UAE’s financial free zones (DIFC and ADGM), the real weight of UAE economic activity and assets lies outside these free zones in the onshore areas.

Prior to the UAE Trust Law, free zone trust arrangements could not effectively govern dealings or enforce or establish ownership rights over UAE onshore assets, whether these comprise cash, securities, land, moveable assets or legal rights. Rather, trust arrangements and their offshore business structures could be implemented only through changes to onshore law. This is now being done, but without the creation of a surrounding and supporting common law legal environment similar to those created in the DIFC and ADGM. We note that the UAE Trust Law does not apply to trusts created in these UAE financial free zones which continue to operate under their own legislative provisions.

The basic elements of an onshore trust

Any Trust to be established under the new Law must incorporate the following elements:

- a Settlor (or donor) willing to declare a trust over property which they own or control;
- property which is identifiable and subject to that declaration of trust;

- a trust instrument in writing evidencing that declaration;
- an identified (or identifiable) Trustee to administer the Trust;
- either:
  - one or more Beneficiaries (identified or identifiable); or
  - an acceptable Purpose for the Trust; and
- registration of the Trust Instrument in a new UAE Trust Register.

The Settlor

Every Trust must have a Settlor, defined as a person who creates the Trust and provides his or her property as Trust assets. The Settlor can create a Trust by "issuing" (signing) the Trust Instrument or by will taking effect after the death of the Settlor. The definition of a Trust Instrument makes it clear that the Settlor must sign it.

Under the Law, a Settlor must have legal capacity and may be a corporate entity. However, for any corporate Settlor the settlement transaction has to comply with corporate action/authority requirements relating to such an entity, for example board approval in the case of a joint stock company and a general assembly resolution in the case of a LLC.

It is possible for multiple Settlors to establish a Trust. In addition, the Trust Instrument can permit multiple Settlors to retain some power to control or recall individual components of the Trust Property, which can be traced back to individual Settlors.

Similar to the concept of a 'reserved power trust' in common law jurisdictions, the Law allows a Settlor to reserve significant amount of control under the Trust Instrument, including:

- whole or partial termination of the Trust;
- amendment of the Trust Purpose;
- amendment of the terms of the Trust Instrument;
- adding or excluding Beneficiaries or changing the rights of any Beneficiaries;
- appointing or dismissing any Trustee or Trust Protector;
- changing the obligations or powers of the Trustee (or making the exercise of powers conditional upon Settlor approval); and
- giving binding instructions to the Trustee on the management, exploitation, investment or disposal of Trust Property.

The Trust Property

The Law contains a wide definition of eligible property, encompassing any moveable or immoveable property, anything related to such property or comprising a part of such property, and any right which exists, or may exist. It applies expressly to any property inside or outside the UAE.

For the property to be settled on the terms of a Trust, the Settlor must be either the owner or the holder of a legal right to dispose of that property prior to the settlement. The law stipulates that the property must not be encumbered with third party rights, unless the relevant third parties so consent.

In extending also to future and contingent assets, the Law further provides for an expansive concept of the type of property rights and assets that can be the subject of a declaration of Trust.

The Trust Instrument

Under the Law a "Trust Instrument" is defined as a written document executed by the Settlor by which a Trust is created and the Trust terms and conditions are regulated. The law confirms that a Settlor may establish a testamentary Trust under the Settlor's will.

UAE onshore Courts are vested under the Law with the power to create a Trust upon the request of a guardian or custodian in cases where the owner of the property lacks legal capacity. The decision of the Court must identify and determine the Trust terms, and the Court's written decision is deemed to be a Trust Instrument.

The Law requires every Trust to be registered in the new UAE Trusts Register, and for the following elements to be identified and noted on the Register:

1. the Trust Purpose or the Beneficiaries of the Trust;
2. the Trust Property;
3. the duration of the Trust;
4. specification of the Trust name; and
5. the powers and authorities of the Trustee

In the case of (2), if no period is specified, then the Trust is deemed "permanent" unless the Court orders otherwise.

The law contains a non-exhaustive list of matters which may be included in the Trust Instrument, including:

1. Beneficiaries' proportionate interest in the trust fund or alternatively rights to be considered (i.e. a discretionary trust);
2. the terms of dealing with Trust Property;
3. the appointment, removal and replacement of any Trustee;
4. the consequences of Trust termination;
5. the regulation of duties and rights as between Trustee, Settlor, Beneficiaries, and Trust Protector; and
6. the appointment and powers of Trust Protector.

The Trust Instrument serves as a binding document on all "Interested Parties", i.e. the Settlor, the Trustee, the Beneficiaries and the Trust Protector.

The trustee

Every trust requires a trustee. To be eligible, a trustee must be either a natural person with legal capacity (i.e. of "good reputation and conduct") or a commercial company licensed as a Professional Trustee.

It is possible for a Settlor to act as a trustee. Currently, we understand that it is intended that new requirements will be introduced for a company to be licensed as a Professional Trustee (to be set out in future regulations), which will enable private companies to act in the future as trustees for family trusts.

The law contains a number of detailed provisions regulating the appointment, removal and replacement of co-Trustees. One interesting provision allows for co-Trustees to "power-share" by dividing responsibilities amongst different powers and authorities if the Trust Instrument so permits. Whilst it does not go so far as to recognise the differing roles of custodial trustees and managing trustees (as is the case under the DIFC Trust Law), it appears clear that these provisions could accommodate and be applied for that purpose.

The powers and authorities of Trustees are detailed in the Law. In general terms:

- Trustees have full power to “manage, use and dispose” the Trust Property and open bank accounts (unless restricted by the Trust terms);
- the Court can override restrictions on disposals of the Trust Property in certain cases;
- the Trust Instrument may contain provisions granting discretions to the Trustee concerning distributions to Beneficiaries; and
- the Court can restrict the Trustee’s powers in certain circumstances.

Additionally, the Law details the positive duties of any Trustee. The most important duties are:

- to exercise the necessary care as a prudent person in performing their powers, authorities and duties.
- to preserve the Trust Property and its value;
- to dispose of the Trust Property in accordance with the Trust Instrument and the Law; and
- to exercise their duties to promote the interests of the Beneficiaries and/or the Trust Purpose.

Other fundamental duties set out include:

- to act “neutrally” as between multiple Beneficiaries / multiple Purposes;
- to disclose their capacity as Trustees in any dealings with third parties;
- to avoid intermingling between Trust assets and the Trustees’ personal assets; and
- to disclose in writing any conflict of interest

Further, the Law effectively expands on the positive duties by setting out some negative duties which are:

- to refrain from using Trust Property for the Trustee’s own personal interest, benefit or unjust enrichment;
- to refrain from permitting a third party to use, exploit or obtain enrichment from the Trust Property;
- to not exploit the Trusteeship so as to damage the interests of the Beneficiaries or the Purpose of the Trust; and
- to not encumber the Trust with unreasonable expenses.

Trustee liability is dealt with by making the trustee liable for “wilful default or gross negligence” and by providing for the invalidation of any transaction disposing of Trust Property in bad faith where a recipient was aware of such bad faith.

Beneficiaries

A Beneficiary is defined as an identifiable or class of person entitled to a right under a Trust Instrument, including a person “possibly included”. Interestingly, the definition expressly includes a person in whose favour the Trustee has authority to create any “security or right” in respect of the Trust Property, which in the author’s view might extend to a lender to the Trust with security over Trust Property.

The Law enables the Trust Instrument to provide for the rights of beneficiaries, and for this purpose the following general provisions apply:

- if the Trust Instrument does not specify shares between more than one Beneficiary, then the Trust Benefits shall be split in equal shares;
- once Trust Benefits become payable to any Beneficiary, then they are deemed part of that Beneficiary’s financial assets;
- a Trust Instrument can provide for exclusion or suspension of any Beneficiary where the Beneficiary becomes insolvent; and
- the Trust Instrument can provide for accumulation of Trust Benefits with payment after a specified

period.

Purpose Trusts

The Law makes it clear that for a valid Trust to be established, it must be established for one or more Beneficiaries or for one or more proper Purposes (or for both).

A purpose can be either for Charitable Purposes or for Special Purposes.

A Charitable Trust is defined as one created for a "humanitarian" purpose. A Special Trust is defined as one with the purpose of "investment and employment of properties".

The Law also permits a Trust to have multiple purposes; or to be established for a mixture of Purposes and Beneficiaries.

The Law contemplates that Special Purposes include both:

- dealing in securities in capital markets; and
- creation of a pension fund or security fund providing benefits to Beneficiaries.

When considered in conjunction with the definition of a Special Trust, it appears that it is envisaged that any mutual funds /securitisation funds/REIT's will take the form of Trusts established for Special Purposes.

Is the onshore Trust a legal entity

In a significant departure from the Anglo-American concept of a trust, the Law provides that a trust is a legal entity. In common law jurisdictions a trust is viewed as a legal relationship connecting the Trustee, the Beneficiary and the Assets; it is not a distinct legal entity, and all dealings are conducted by the Trustee as a principal with rights of indemnity against the trust assets.

However, the UAE Trust Law establishes a new entity which most closely resembles civil law statutory Foundation entities. In particular, assets can be held and registered directly in the name of the incorporated Trust, and Trustees have functions which are more akin to those of general managers in the context of LLCs.

In our view, the incorporation of an UAE Trust is likely to offer significant advantages and protections in practice to settlors contemplating trust structures in the UAE, including

- the Trust entity will enjoy perpetual succession, enabling assets to be held within a stable structure;
- inevitable changes in trusteeship will not disturb the asset holding and will not entail cumbersome expensive and time-consuming transactions;
- the Trustee would enjoy the same shield of limited liability available to an officer of a commercial company; and
- the incorporation of the Trust offsets the limitation that any corporate Trustee must be a licensed Professional Trustee.

There are some provisions of the Trust Law which seem, at first, to envisage the Trustee being the holder/custodian of the Trust Property, but most can be read down as restricted to cash, moveable property or records. The most difficult provisions to read down are contained in Article 21, which deals with the lapse of a Trustee's authority.

Article 21(2) requires such a Trustee to “transfer rights in respect of the Trust Property” to a new Trustee, and describes the lapsed Trustee as “custodian of the Trust Property” until the handover is complete. Article 21(4) requires the heirs of a lapsed Trustee to “transfer the Trust Property in their possession”.

Whilst the incorporation of the Trust offers clear benefits, it also raises questions about how such an entity fits into the onshore legal and regulatory system, for example:

- can the entity obtain and hold a trade license?
- can the entity hold real property?
- how is the nationality of the entity to be determined? By the nationalities of the Trustee or the Beneficiaries?
- if the entity becomes insolvent, is it subject to the UAE Bankruptcy Law or would it be wound up under the Trust Law?

These and other practical issues will no doubt play out quite speedily in precedents as the Law becomes known and its provisions are tested by trust practitioners active in the UAE.

Mandatory registration requirements

As noted above, the Law requires registration of a Trust, and this is a pre-condition to enforceability and validity because the Law provides that the Trust comes into effect upon completion of the registration procedure.

We understand that the new Register of Trust Instruments will be established by future regulations.

The Office of Trust Protector (optional)

The Law permits the appointment of a Trust Protector by the Settlor. The concept of the office of Trust Protector is to serve as a check on the Trustee.

In cases where a Trust Protector is appointed, the Law provides that the Trust Protector will:

- review the Trustee’s performance;
- require the Trustee to discharge the Trustee’s duties; and
- have the capacity to sue the Trustee for breach of duty.

The Law imposes negative duties on any Trust Protector:

- to avoid conflicts of interest;
- not to obtain benefits or unjust enrichment from the office;
- not to permit any third party to enjoy unjust enrichment from the Trust; and
- not to enter into transactions with the Trustee or any transactions benefiting the Trust Protector or the Trustee.

Further, the Trust Instrument can confer the powers on the Trust Protector to appoint, replace and remove Trustees and to determine the powers and fees of any Trustee. It is also open to the Trust Instrument to make the exercise of the Trustee’s powers and authorities subject to the approval of the Trust Protector.

Significantly, a Settlor can hold the office of Trust Protector (and a Trustee cannot), and to the extent of the powers potentially retained by the Settlor in that role, and his or her continuing influence on the operation of the Trust, represents another important way in which the UAE Trust differs from trusts at common law, where the Settlor's role and potential for variation of or influence on the Trust once created is substantially constrained.

The role of the Court

The Competent Court is defined as the Court having the competence pursuant to the Civil Procedures Law.

The Court has extensive and significant powers under the Trust Law and, in particular, exercises oversight over Trustees accused of behaving in a dishonest or negligent fashion. The Court is also provided with powers to effectively repurpose Trusts in particular circumstances, for example where a Charitable Trust with extremely general provisions is created but specific purposes are not identified.

The Court has the additional role of providing access, upon application as required, to Trust records and Trust audits to Protectors and Beneficiaries, and of removing and replacing Trustees where circumstances demand.

The Court has the power to invalidate Trusts on a range of grounds extending to illegality, inconsistency with public policy, technical non-compliance, forgery, fraud and mistake.

Additionally, the Court may terminate a Trust where circumstances have changed, where no Beneficiary remains or where the Trust Property is depleted. Upon termination, the Court may make orders determining the manner in which Trust Property is distributed.

It is therefore clear that the Court has broad jurisdiction over the supervision and control of the affairs of every Trust, and can be asked to intervene in a wide variety of circumstances. However, the Law does not confer a general right upon any Trustee to approach the Court for guidance on any aspect of the Trustee's duties, (and in this respect the Law contrasts with common law jurisdictions where the declaratory and advisory jurisdiction of courts of equity are a feature of trust practice).

Conclusion

Inevitably, a new law with no previous precedent in the civil law system will require time to be understood and the advantages of its use appreciated. Indeed, in the case of the new UAE Trust Law there are likely to be immediate challenges ahead in how onshore Trusts will operate in practice. In particular, the recognition across the UAE commercial and regulatory landscape of the UAE the new Trust Law will require all key authorities and stakeholders to understand and give effect to a new conception of property rights, where beneficial and legal interests diverge. Allied to this challenge, the onshore Courts in each Emirate will be called upon, as practice develops, to carry out extensive and wide-ranging functions in the administration of onshore Trusts. Given the relative lack of judicial history and experience in these areas, it is to be hoped that some dedicated judicial training will accompany the roll-out of the Law.

The immediate impact of the Law is nevertheless clear the fundamentals needed to establish viable trust arrangements onshore are explicitly put in place and can begin to be incorporated in business and family wealth management structures. The fundamental step has been taken to recognise the co-existence of legal and beneficial rights in the same Trust Property as part of UAE law, and it is apparent that the relations, rights, duties and powers familiar to common law trust practitioners are broadly reflected in the codified provisions, with some modifications of the Law. As a result, the UAE Trust Law is set to succeed in its objective of permitting and facilitating the type of sophisticated family and financial arrangements which are utilised in other trust jurisdictions. The Law serves to fill a number of obvious gaps in the onshore legal system, and it will likely spur major developments in onshore law and practice.

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