The Private Wealth & Private Client Review

Third Edition

Editor
John Riches

Law Business Research

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John Riches

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EDITOR'S PREFACE

The scope and tone for my introductory remarks this year is set by referencing a combination of Henry Christensen and George Hodgson's articles. We all know that the Foreign Account Tax Compliance Act (FATCA) was a unilateral attempt by the United States to obtain information on the non-US financial interests of US citizen taxpayers. The response of other Organisation for Economic Co-operation and Development (OECD) countries has transformed from an initial stance of reticence and scepticism to one where FATCA has become the catalyst for the Common Reporting Standard (CRS). The publication in February 2014 by the OECD of the document entitled 'Standard for Automatic Exchange of Financial Account Information Common Reporting Standard'[1] paves the way for comprehensive disclosure on cross-border financial interests by individuals and related entities, and automatic exchange of that information by participating states from 2016. It is therefore worth pausing at this particular point in time to seek to discern what the aggregate effects of FATCA and CRS will be. Some may be less obvious than others.

Greater transparency

Starting with the obvious, it is apparent that for the families who are tax compliant with cross-border interests, and us as their advisers, greater transparency will create a different context within which planning is undertaken. We have become accustomed in more recent years to a 'self-assessment' paradigm where the burden of disclosure fell on individual taxpayers, who disclosed matters that they considered to be germane to the assessment of their tax affairs. In the post-FATCA/CRS world, this paradigm will change. Revenue authorities will be receiving significant amounts of spontaneous information about taxpayers' foreign financial interests through FATCA and CRS. Much of this

1 www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Common-Reporting-Standard.pdf.

information may duplicate data that has already been filed directly with the relevant individual's domestic tax authority, but nonetheless it is likely to create an environment in which more cross-checking of such data is undertaken, especially where it relates to entities such as trusts and foundations of which the individual is a beneficiary. This places a greater onus on advisers to ensure that our clients' tax filings are scrupulously accurate, as the overall trend seems set to be one in which revenue authorities are likely to adopt a less forgiving attitude to innocent mistakes.

Scrupulous compliance and record-keeping

It is also apparent that the maintenance of appropriate records will become more important. Tax authorities may not audit an individual's tax affairs for a number of years after these new initiatives take effect. When an audit occurs, it is likely to be important to be able to demonstrate that the structure did report the taxpayer's interest in relevant cases and to link this with the individual's personal tax filings where relevant.

Substance

A second, if less direct, consequence of transparency is the importance of ensuring that trusts, foundations and companies that are organised and resident in a particular jurisdiction have the appropriate substance there that can be demonstrated should the need arise. In a more transparent environment, the connections that exist between individuals as 'ultimate beneficial owners' and entities located in different jurisdictions will be more apparent. The policy thrust of seeking to identify not only settlors but those exercising oversight in a fiduciary capacity (such as protectors and enforcers) and those seen as 'exercising effective control' will mean that tax and regulatory authorities may be disposed to satisfy themselves that the operations of entities that are located in specific jurisdictions are being genuinely conducted there and that there are no 'short cuts' that are capable of generating a different tax analysis.

Anticipating this type of change, it would be prudent for those engaged in managing those entities to be in a position to demonstrate appropriate 'mind and management'. In this context, it will be critical to ensure that there is consistency between formal board or meeting minutes and informal communications with beneficial owners, properly conducted meetings held at the right time and sufficient time given for reflection before decisions are taken. This could be a good time to stress test substance given the enhanced likelihood of tax audits in future.

Scope for simplification

There may be instances where there is a 'silver lining' to the increased reporting burden. There is a basic precept of all planning that suggests that where one is in doubt, it is always better if possible to establish a simpler structure with fewer layers. The principal justification for this approach is that consequential changes are always more complex in structures where one has more 'moving parts' to address. When establishing new structures therefore, it may be that as advisers we will tend to be more sceptical about the value of the use of underlying companies and choose to hold assets, for example, directly at the level of the trust or foundation. Where existing compliant structures are concerned, both advisers and families may also be less inclined in future to embrace 'complexity' and prefer to concentrate on being able to demonstrate the substance of

those layers that are required to execute the relevant planning objective. In this context it should not be forgotten that a key issue that creates greater complexity is the need to demonstrate the movement of value between layers in a structure, whether by way of loan repayment, dividend or appointment. It is also critical to note that where one is looking for flexibility and portability, a simpler structure is one that can be effectively 'lighter on its feet' should the need for change arise. This is not least demonstrated in the context of the requirement to provide comprehensive customer due diligence on the entire structure to relevant financial institutions or service providers.

Risk of confusion

There is undoubtedly going to be a scope for very significant confusion to arise with the advent of the new rules. For instance, the test of where an entity is deemed to be resident for the purposes of FATCA/CRS may well generate different outcomes. Some structures may be dual resident by being deemed to be resident in the country of incorporation as well as in the country of effective operation, and the initial stance of authorities at this point may be to prefer duplicate reporting where an entity falls to be treated as resident in more than one jurisdiction.

Another term open to significant ambiguity is that of 'any other natural person exercising ultimate effective control over the trust' referred to in the CRS definitions at Section VIII in the context of 'Controlling Persons'.[2] It is very uncertain at this stage how this phrase would be interpreted in the context of complex fiduciary structures. Is it, for instance, invoked by the use of reserved power trusts that may give administrative powers such as those relating to investment to a third party other than the settlor, or is it mainly intended to apply to dispositive powers? Will it apply to governance powers that allow a third party to intervene to hire and fire protectors, who can in turn appoint and remove trustees?

There are bound to be 'teething problems' of this nature, where both tax authorities and service providers will need clarity. What is essential is an ongoing engagement with policymakers that provides practical and usable guidance that minimises ambiguity.

Reporting profile of different fiduciary structures

At this early stage in the development of guidance on FATCA and CRS disclosure on entities, it is interesting to note that discretionary structures would appear to have a much lower reporting profile than those which revolve around the existence of fixed income interests. While there is no available CRS guidance in the public domain, there is analogous guidance in draft that has been published in the context of both FATCA and the United Kingdom's intergovernmental agreements (IGAs) with its Crown Dependencies (CDs) and certain of its Overseas Territories.[3]

2 www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Common-Reporting-Standard.pdf

3 Draft CD Guidance was published in January 2014, while the Cayman Islands published its own draft guidance in May 2014

Specifically for trusts requirements to disclose information as a beneficiary will, in the case of a trust where an individual has an income interest, oblige, currently, a filing of underlying capital values of fiduciary assets while, in the case of discretionary trusts, the guidance directs that the disclosure should be limited to distributions made in the relevant year (this extract has been taken from the draft CD Guidance on FATCA and the United Kingdom IGAs issued on 31 January 2014):[4]

> *The total value of the assets of the trust must be consistent with that used by the trustees for valuation purposes and should be based on a recognised accounting standard. Listed securities should be valued at the appropriate market. The Equity Interest attributable to the settlor of any settlor interested trust is the whole value of the trust. Where a settlor is excluded from the trust, the Equity Interest can be considered to be nil but will still be a Financial Account and hence reportable.*
>
> *The Equity Interest of a beneficiary that is entitled to mandatory distributions (directly or indirectly) from a trust will be the net present value of amounts payable in the future and should be measured on a recognised actuarial basis. It is recognised that this may be difficult and expensive to calculate in which case it is permitted to use the accounting net asset value of the assets in which the beneficiary has an interest.*
>
> *For a discretionary trust, the Equity Interest attributable to a beneficiary in receipt of a distribution will be the amount of the distribution made in the relevant reporting year.*

The strongly contrasting nature of the level of disclosure required here may cause families and their advisers to reflect carefully on the merits of continuing with fixed interest structures.

As a separate matter, it is notable that settlor-interested structures are similarly ones where full disclosure of capital values on an annual basis will be required. It may be that in this environment settlors may choose to ring-fence their interests to a smaller portion of overall value on the basis that their personal financial needs will not require them to have access to the entire capital value of an ongoing structure.

Profile of fiduciaries

An inevitable consequence of the new rules for trusts will be a requirement to give greater disclosure about fiduciaries involved. This is implicit in the Financial Action Task Force guidance on fiduciary holding structures (see recommendation 25).[5] Where those acting, in particular, as protectors are required to provide information to authorities, families may wish to reflect on the merits of involving family friends or indeed close relatives in this capacity given that, in some cases, the inference that will be drawn by revenue authorities will be less positive than in circumstances where an independent third party is serving in this specific role.

4 www.gov.gg/CHttpHandler.ashx?id=86124&p=0.

5 www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

It will be interesting to see what will happen if the only nexus between a fiduciary holding structure and another jurisdiction is a resident protector with no other role. Will the protector's status be required to be reported on an otherwise nil return?

Tax transparent entities

Another possible consequence of the changes might be to favour structures that have legal substance but are accepted by authorities as tax transparent. In particular, the use of partnership entities may become more popular because of their ability to insulate fiduciaries from certain legal risks that arise from the direct ownership of assets in the same way as corporate entities, without generating the additional complexity of further 'layers'.

Public registers

In a European Union context, there is significant political support for certain information on trusts to be made public.[6] This has been linked to initiatives in the United Kingdom to make public beneficial owners of companies.[7] There are strong arguments that can be made to oppose trust registers, not least in the context of exposing vulnerable individuals to risk if the existence of trusts in which they are named beneficiaries falls into the public domain. What is clear though is that the imminent arrival of automatic exchange of information on a global basis under CRS and FATCA will mean that the information relevant to trusts and similar entities will be available to tax and regulatory authorities, which will have the capacity to create registers of their own. Thus the only open issue that remains is whether such information is confidential and only available to competent authorities or whether some will be placed in the public domain.

In summary, we are on the threshold of a new environment that is bound to generate a significant amount of change. Clients will be looking to us as advisers to do our best to help them plan effectively in this new environment.

John Riches
RMW Law LLP
London
September 2014

6 www.europarl.europa.eu/news/en/news-room/content/20140307IPR38110/html/Parliament-toughens-up-anti-money-laundering-rules.

7 www.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf.

Chapter 35

UNITED ARAB EMIRATES

Amjad Ali Khan and Abdus Samad[1]

I INTRODUCTION

The United Arab Emirates (UAE) is a federation of the seven emirates of Abu Dhabi, Dubai, Sharjah, Ajman, Fujairah, Ras al-Khaimah and Umm al-Quwain. The city of Abu Dhabi in the emirate of Abu Dhabi is the federal capital. The emirate of Abu Dhabi is the largest emirate by area and population and the wealthiest in terms of oil resources. Dubai is the second-largest emirate by area and population and is the trade and financial hub of the region.

As a hub for cross-border trade, financial services and an important market in the oil and gas industry, the UAE is home to numerous ultra-high-net-worth individuals and family conglomerates.

The UAE and, in particular the Dubai International Financial Centre (DIFC) (which is a federal financial free zone in the emirate of Dubai) is home to a number of the world's leading wealth and asset managers, servicing the needs of their local and regional clients.

There are no personal or corporate income taxes in the UAE at the federal or emirate level other than emirate level income taxes on oil-producing companies and foreign banks. There are no exchange controls on the remittance of funds. Additionally, the UAE enjoys relatively low import tariffs and there are few restrictions on foreign trade.

The UAE is considered to be one of the most politically stable and secure countries in the region and consequently is regarded as a safe haven for investment in the region and a destination for tourists. The UAE has been immune to political upheavals or social unrest.

1 Amjad Ali Khan is managing partner and Abdus Samad is an associate at Afridi & Angell Legal Consultants.

II TAX

One of the UAE's most significant attractions is the absence of taxation and the ease of remitting money into and out of the country.

A UAE corporate entity may be used for payment or receipt of royalty, interest or dividends. These structures can be established to take advantage of the UAE's extensive double taxation treaty network.

The UAE has signed double taxation avoidance treaties with over 60 jurisdictions, including China, Hong Kong, Singapore, Japan, Switzerland, Mauritius, the Seychelles, Ireland and Cyprus. Through these agreements, and by obtaining tax residency status in the UAE, it is possible to structure investments in a tax-efficient manner.

i UAE residency

It is possible for a foreign investor to become a UAE resident by establishing a corporate entity in the UAE (this may also be done by setting up a corporate entity in one of the UAE free zones (on which, see further below)) and obtaining a residence visa sponsored by such a company. The foreign investor will require an employment contract with such a company to obtain a residence visa (such employment contracts are customarily standard form documents prescribed by the authorities).

To maintain a UAE residence visa, a UAE resident must return to the UAE within six months of departure. There is no other requirement to maintain status as a UAE resident.

ii US Foreign Account Tax Compliance Act (FATCA)

The UAE Central Bank has recently announced that the UAE proposes to enter into a Model 1 intergovernmental agreement (IGA) with the government of the United States. Once the IGA has come into force in the UAE, banks (including wealth managers falling within the scope of the IGA) will be required to (1) identify accounts that qualify as 'US Reportable Accounts' (2) submit reports on such accounts to the UAE Central Bank, which shall share this information with the US Internal Revenue Service.

Commercial banks in the UAE will comply with the reporting requirements under FATCA and have already taken steps to ensure that they are able to identify those accounts and customers to which FATCA reporting obligations may apply. This may potentially be a cause for concern for those individuals and businesses to which FATCA applies.

III SUCCESSION

Under UAE law, inheritance is governed by UAE Federal Law No. 5 of 1985 (the Civil Code) and by UAE Federal Law No. 28 of 2005 (the Personal Status Law).

All inheritance matters within the UAE are dealt with by the shariah courts. The shariah courts apply principles of Islamic shariah.

Article 17(5) of the Civil Code provides[2] that where real estate is concerned, UAE law shall apply to wills.

Article 1(2) of the Personal Status Law provides[3] that an individual who is resident in the UAE at the time of death may seek to avoid the application of the Personal Status Law (and thus avoid the rules it prescribes in relation to the fixed proportions for the heirs of the deceased). However, the Personal Status Law does not expressly amend the Civil Code and, accordingly, it remains unclear whether a non-Muslim foreigner may seek to avoid the application of principles of shariah in relation to the inheritance of real estate located in the UAE.

One issue with real estate is that even where the deceased leaves a will it may be contested by the heirs of the deceased on the grounds that a will not made in accordance with the shariah contravenes the provisions of Article 17(5) of the Civil Code.

Article 17(1)[4] suggests that, so far as moveable assets are concerned, inheritance shall be governed by the law of the jurisdiction in which the testator is domiciled (for non-UAE nationals, this would normally be the country of their nationality, assuming that only one passport is held).

Accordingly, in so far as moveable assets (such as funds in bank accounts, shares and securities) are concerned, it is possible for a non-Muslim foreigner to provide for the devolution of moveable assets in a manner selected by him or her.

To avoid uncertainty non-Muslim foreigners generally own real estate in the UAE through corporate entities, which avoids the application of shariah law to the inheritance of real estate.

IV WEALTH STRUCTURING AND REGULATION

UAE law (outside the DIFC) does not provide for the creation of trusts. Notwithstanding the foregoing, the UAE courts will generally acknowledge a duly created foreign trust pursuant to the laws of a foreign jurisdiction. A trust can, however, be created pursuant to DIFC law (which is based on general principles of English common law).

To provide clarity for the purpose of succession planning, it is common to structure the ownership of assets through bodies corporate. One further option is to establish a foreign body corporate to own UAE assets to avoid the application of UAE inheritance law and effectively allow overseas distribution of assets based in the UAE.

The emirate of Dubai permits property to be registered in the name of offshore companies established in the Jebel Ali Free Zone (subject to rigorous due diligence

2 Article 17(5) provides that the laws of the United Arab Emirates shall apply to wills made by aliens disposing of their real property located in the state.

3 Article 1(2) provides that this Law shall apply to citizens of the United Arab Emirates state unless non-Muslims among them have special provisions applicable to their community or confession. This shall equally apply to non-citizens unless such a non-citizen asks for the application of his or her law.

4 Article 17(1) provides that inheritance shall be governed by the law of the legator at the time of his or her death.

and 'know your customer' requirements. For such a company to own property in Dubai, approval must be sought from the Dubai Lands Department. Such approval is discretionary and the Dubai Lands Department has previously suspended approvals for such structures without prior notice.

If such a structure is used, the share capital of such an offshore company may in turn be owned by a foreign offshore company (e.g., a company incorporated in the British Virgin Islands). Any transfer of ownership of UAE assets owned through such a structure can then take place offshore but may still trigger the payment of transfer fees where the assets include real estate.

For real estate located within the DIFC, it is permissible to hold property in the name of an offshore entity or trust. To do so, an investor must satisfy the due diligence requirements of the DIFC Registrar of Real Properties. This procedure may also involve disclosure of the ultimate beneficial owner of the real estate. Note that DIFC Law No. 4 of 2007 (as amended by DIFC Law No. 4 of 2012) (the DIFC Real Property Law) contemplates that transfers of shares in an unlisted company shall fall within the definition of a 'transfer' and accordingly trigger both (1) payment of transfer fees (currently at five per cent of the higher of the transfer or market price) and (2) a filing with the DIFC Registrar of Real Properties in relation to the transfer. Note that transfers of real estate that constitute a personal restructuring (for example a transfer from an individual to a corporate entity that is wholly owned by such an individual) does not trigger the payment of transfer fees but will still require the submission of a filing with the DIFC Registrar of Real Properties.

Once established, regulation and oversight of companies in the UAE (outside the DIFC) is generally non-intrusive. The relevant regulator will only enquire into the affairs of a company if it suspects that illegal activities are being conducted or if the company fails to renew its annual licence or property lease. Corporate actions (e.g., changes of directors, managers, shareholders or amendments to the company's constitutive documents or share capital) are just about the only times when regulators must be approached.

Each free zone authority requires its own level of regulatory compliance and generally these authorities do not interfere in the affairs of companies established within their respective jurisdictions. Note, however, that companies incorporated in the DIFC (and especially those regulated by the Dubai Financial Services Authority, the independent regulator for the DIFC) are subject to extensive reporting requirements, which are strictly enforced.

i DIFC Single Family Office regime

It is also possible for high-net-worth individuals to use the UAE as an administrative base from which to manage their investments. One option for setting up such an office is the DIFC. The DIFC offers a convenient location, developed infrastructure and a sophisticated legal system that can be used by high-net-worth individuals and families to manage their wealth.

Such individuals or families may establish a Single Family Office in the DIFC. Such an office would be licensed pursuant to the DIFC Single Family Office Regulations (the SFO Regulations). A Single Family Office established in the DIFC can be used to

service the needs of a 'Single Family'[5] (see below for further information on this), which can cover the following services:

a the provision of services to one or more 'Family Members';[6]

b the provision of services to a 'Family Fiduciary Structure';[7]

c the provision of services to a 'Family Entity';[8] or

d the provision of services to a 'Family Business'.[9]

A Single Family Office in the DIFC is a potentially useful base from which high-net-worth individuals can manage their administrative, financial and investment decisions.

ii Anti-money laundering regime

Money laundering is a criminal offence in the UAE. The UAE has put in place a rigorous anti-money laundering regime. Currently, this regime is governed primarily by UAE Federal Law No. 4 of 2002 (the AML Law) and by the UAE Central Bank Regulation No. 24 of 2000 (as amended) (the AML Regulation).

The AML Law states that the following shall constitute money laundering:

a the transfer, transport or deposit of funds with an aim to disguise or conceal an illegal source; and

b the acquisition, possession or use of such funds.

In addition to the AML Law, financial institutions are required to comply with the AML Regulation. The AML Regulation specifies checks that financial institutions must put in place to prevent, detect and, where applicable, report suspected or confirmed money laundering activities.

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5 A family constitutes a 'Single Family' either where it comprises one individual or a group of individuals all of whom are the bloodline descendants of a common ancestor or their spouses (including widows and widowers, whether or not remarried); or subject to such other limitations or conditions otherwise agreed with the Registrar. It is envisaged that all members of a family will be included in a Single Family and that individuals adopted as minors, stepchildren, children of adopted children and all biological children of a qualifying family member shall be regarded as members of the Single Family.

6 In references to a Single Family, a 'Family Member' means an individual forming part of the group of individuals comprising the Single Family.

7 'Single Family Fiduciary Structure' means a trust or other similar entity (such as a foundation): of which a Family Member of a Single Family or a Family Entity related to the Single Family is the settlor or Founder; and the beneficiaries of which, or persons otherwise capable of benefitting from which, are all: (1) Family Members; (2) charities; (3) Family Entities; or (4) other Family Fiduciary Structures related to the Single Family.

8 'Family Entity' means an entity (such as a body corporate or partnership) controlled by a Single Family.

9 'Family Business' means a business (whether a body corporate or partnership) controlled by a Single Family.

Media reports have indicated that the UAE federal government is planning to introduce a number of amendments to the AML Law. It is anticipated that these amendments will seek to broaden the type of activities that may constitute money laundering.

In addition to the AML Law and the AML Regulation, entities operating in the DIFC are required to comply with the Dubai Financial Services Authority's Anti-Money Laundering, Counter-Terrorist Financing and Sanctions Module (the DFSA AML Module). The DFSA AML Module seeks to provide a single point of reference for those entities that are regulated by the DFSA.

V CONCLUSIONS AND OUTLOOK

The UAE enjoys a stable political and economic outlook. The zero-tax environment (which is not expected to change), combined with the relative ease of doing business, means that the UAE has the potential for further economic progress.

It is expected that, in line with international trends, the UAE will enhance regulation of financial and wealth management services. In particular, one key trend that is expected to play an important role in future regulatory activity is the regulation of foreign private wealth managers servicing clients in the UAE without a presence in the UAE. The UAE Securities and Commodities Authority has recently also introduced regulations to curtail marketing and sales activity in the UAE by unlicensed individuals and entities from outside the UAE. In particular, it has issued a number of regulations addressing how investment funds, securities and financial services can be marketed to residents of the UAE.

Appendix 1

ABOUT THE AUTHORS

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Amjad Ali Khan is the managing partner and a co-founder of Afridi & Angell. He represents foreign and local clients including banks and leading multinationals in banking, financial and corporate transactions in the UAE and abroad. He has considerable experience in undertaking conventional, Islamic and private banking transactions. He is regularly involved in project finance, syndicated loans and treasury products transactions.

Mr Khan is the co-author of *The Banking Regulation Review* (UAE chapter) and is a regular speaker at banking seminars.

ABDUS SAMAD
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Abdus Samad has extensive experience advising foreign and local clients on general corporate, commercial and other matters related to the conduct of business in the region including setting up companies and joint ventures in the UAE, corporate investments, restructuring, and the acquisition and sale of business.

Mr Samad has also been involved in banking and finance transactions, and advises clients on banking related products and services such as the launch of the direct debit system in the UAE.

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