The Private Wealth & Private Client Review

Fourth Edition

Editor
John Riches

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The Private Wealth & Private Client Review

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CONTENTS

EDITOR'S PREFACE

There is no doubt that the twin recurring themes for 2015 at a global level in private wealth planning are those of transparency and regulation. The zeal of policy makers in imposing ever more complex and potentially confusing sets of rules on disclosure of beneficial ownership information seems unabated.

i Common reporting standard (CRS)

The centrepiece of cross-border automatic information exchange is CRS. This FATCA equivalent for the rest of the developed world is set to come into effect from 1 January 2016. At the last count just over 90 countries had committed to CRS. Its principal effects will be felt in two waves – among the so-called early adopters group the rules will take effect from 1 January 2016 and first information exchanges will apply in September 2017. For the second wave, there will be a year's delay.

What is interesting about CRS is that the OECD has taken a central role in producing coordinated guidance on its interpretation. The draft guidance initially published in July 2014 was somewhat sketchy in nature and we can expect, as we move towards the beginning of next year, revised and more detailed guidance on a number of key issues.

Deep concerns exist about the extent to which information exchange between tax authorities under CRS will remain secure in the hands of the 'home' countries of beneficial owners. While the 'normal' way of signing up to CRS is via the multilateral convention that provides for exchange with other signatory nations, there are indications that some jurisdictions (at this stage the Bahamas, Hong Kong and possibly Switzerland) may seek to adopt a more 'bilateral' approach implementing CRS. If this approach becomes more widespread, then the practical implementation of CRS could be significantly delayed by jurisdictions who negotiate treaties on a one-by-one basis with 90 other countries.

While CRS is often compared to FATCA, there are some material differences that emerge from closer scrutiny. Whatever the shortcomings of FATCA, the ability to issue a global intermediary identification number and to sponsor entities on a cross-border basis somewhat lessens the bureaucratic excesses of its impact. What is distinctly unclear about CRS at this point is whether equivalent mechanics will emerge. As CRS is currently written as a series of bilateral treaties between jurisdictions with no domestic law 'anchor' (as is the case with FATCA) concerns are being expressed about the potential duplication for complex cross-border structures of reporting. In this context, the July 2014 introduction to CRS notes that the rules as to where a financial institution (FI) will be deemed resident differs between jurisdictions – in some cases this will be based on the place of incorporation whilst in others it may be based on the place of effective management.

There are concerns as to how non-financial entities (NFEs) will be dealt with under CRS. There is anecdotal evidence emerging already in the context of FATCA that financial institutions, driven by concerns about fines from regulators for NFEs and the related ownership structure are subjecting bank account applications for NFEs to additional enquiries that generate very significant costs and delay.

It is noteworthy that there has been a significant crossover from the anti-money laundering (AML) or terrorist financing regime coordinated by the Financial Action Task Force (FATF). This is expressly provided in the CRS model treaty that imports into CRS the FATF concept of beneficial ownership. In the CRS world, this is known as 'controlling persons'. By expressly linking the definition of controlling persons to that of beneficial ownership employed for FATF purposes, there is the prospect of the beneficial ownership definition evolving over time in accordance with principles adopted in that domain. It is noteworthy that, as well as looking to ultimate legal and beneficial ownership of an entity, these definitions also look to the capacity to exert influence and control in the absence of any formal legal entitlement. Thus the expanded definition is as follows.

Beneficial owner refers to the natural person who ultimately owns or controls a customer or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.[1]

It is completely appreciated that, in a law enforcement context, criminals and terrorists do not typically advertise their involvement in ownership structures where they are liable to be detected by the appropriate agencies. Transporting this definition wholesale, however, into the world of tax information exchange where domestic tax authorities may draw unfair and adverse implications from an attribution of being a 'controlling person' is more questionable. It is not a complete response to this concern to say, in the final analysis, if someone has no ability to enjoy the benefit of assets held within a particular structure that they can demonstrate this – the potential costs and bureaucracy of an unwarranted tax audit that may arise from such a misunderstanding will be more difficult to quantify.

Another area of concern is the capacity for banks who have, in the past, misclassified or misunderstood information about ownership structures. If this information is simply

1 http://www.fatf-gafi.org/pages/glossary/a-c/ – The Recommendations were adopted by FATF on 16 February 2012. (emphasis added).

'copied over' from AML records for CRS purposes then there is scope for false and misleading information to be exchanged in circumstances where the 'beneficial owners' may be completely unaware of such mistakes or misclassifications.

What follows from this is an increased importance for professional advisers to actively engage with clients to discuss the implications of these changes. Taken together, the combined impact of these changes is likely to be seen in years to come as a 'paradigm shift' in international wealth structuring. It is therefore critically important that the advisory community equips itself fully to be able to assist in a pro-active manner.

ii Public registers of beneficial ownership

On 20 May 2015, the EU published the final version of its fourth anti-money laundering directive (4AMLD). This commits the EU Member States to providing a public register of beneficial ownership within the next two years. What is noteworthy about the terms of the regulation is the fundamental distinction that has been drawn between ownership information about 'legal persons' (including companies and foundations) on the one hand, and 'legal arrangements' (including trusts) on the other. There is an obligation for information on legal persons to be placed in the public domain while information relating to trusts and equivalent arrangements will be restricted so that it is only made available to competent authorities.

The acceptance in the drafting of these regulations that there is a legitimate distinction to be drawn between commercial entities that interact with third parties, primarily in the context of business arrangements, and private asset ownership structures that are primarily designed to hold wealth for families is an encouraging one.

It should not, however, be assumed that the emphasis on privacy that underpinned this particular distinction will necessarily be a permanent one. There is a very strong constituency within the EU that still argues that a public register of trusts should be introduced at some stage in the future.

Turning to the UK, 2016 will see the introduction of a public register of beneficial ownership for companies in the UK. This legislation, to a large extent, anticipates the impact of 4AMLD although it is not completely symmetrical. The centrepiece of UK domestic legislation is the public identification of persons with influence over UK companies, known as 'persons exercising significant control' (PSCs). There are significant penalties for non-compliance. In particular, in circumstances where a PSC does not respond to the request for information from a company, not only can that refusal generate potentially criminal sanctions, it can also result in any economic benefits deriving from the shares as well as the ability to vote being suspended.

While it is appreciated that there are reasons why sanctions need to be applied to encourage people to comply, the harsh economic penalties may be seen as totally disproportionate to non-compliance. It is interesting to note that the PSC concept analogous to that of the 'controlling persons' in the context of CRS. As with CRS, the most complex area here is the extent to which those being seen to exert 'influence' without formal legal entitlement may be classified as PSCs.

One further interesting issue that needs to be considered as matters move forward is whether the impact of the EU public register for corporate entities will result in a 'back door' trust register in many cases. One of the categories for disclosure of PSCs in the UK register is 'ownership or influence via a trust'. In circumstances therefore where a trust holds a material interest in a company, this can result in not only the trustees and protectors of the trust, but also family members with important powers (such as hire and fire powers) being classified as PSCs and having their information placed on a public register. While this register will not give direct information about beneficiaries as such, in many cases it will provide a significant degree of transparency about family involvement. It seems likely that, over time, the EU will also look to 'export' a requirement for beneficial ownership information on public registered companies to be incorporated in many of the international finance centres. While IFCs have indicated that they are sceptical about the adoption of such registers in circumstances where there is not a common standard applied to all jurisdictions, it remains to be seen how long this stance can be maintained once 4AMLD is in full force.

iii Position of the United States

The United States stands out as having secured a position for itself in the context of cross-border disclosure that many feel is hypocritical. Specifically there is a carve out from CRS on the basis that the US has implemented FATCA. The constitutional position in the US where measures of this nature would tend to be introduced at a state rather than federal level also complicates the picture. In the absence of any comprehensive regime to regulate trustee and corporate service providers, the US appears to have achieved a competitive advantage in administering 'offshore' structures because it has exempted itself, in practical terms, from reciprocation on automatic information exchange. This is already leading to many considering the US as an alternative base from which to administer family structures in a more 'private' setting than is possible in IFCs once CRS take effect.

iv Global legal entity identifier system (GLEIs)[2]

A development flowing from the 2008 financial crisis is the introduction of GLEIs. In December 2014 a regulatory oversight committee relating to GLEIs introduced a task force to develop a proposal for collecting GLEIs information on the direct and ultimate parents of legal entities. The policy is to ensure financial intermediaries can track who they are dealing with as counterparties in investment transactions. The underlying policy that drives the creation of the GLEIs is to create transparency in financial markets. In the current phase 1 of the project, the information required to be collected is limited to 'business card information' about the entities concerned and will therefore be limited to a name, address and contact number. However, the 'level 2' data that is likely to be required will extend the reference data to relationships between entities. This could result in beneficial ownership information being required in due course. This proposal is likely to see some development in the course of the next six months but is yet another illustration of overlapping regimes for collecting beneficial ownership information that are likely to have a substantial effect on the operation of family wealth holding structures in the years ahead.

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2 http://www.leiroc.org/.

v Conclusion

The challenges of keeping abreast of changes in the regulatory and transparency arena are significant. These issues look set to be a significant driver in wealth strategy in the next three to five years. Navigating these issues will increasingly become a required skill set for professional advisers.

John Riches
RMW Law LLP
London
September 2015

Chapter 39

UNITED ARAB EMIRATES

Amjad Ali Khan, Stuart Walker 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 unaffected by political upheaval or social unrest.

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1 Amjad Ali Khan and Stuart Walker are partners and Abdus Samad is an associate at Afridi & Angell.

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 (see 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 OECD memorandum of understanding

In the middle of 2013 the UAE Ministry of Finance and the UAE Central Bank signed a memorandum of understanding (MoU). The MoU contains an agreement to share tax-related information of all UAE bank customers with all countries that have double-taxation agreements with the UAE. The UAE has double-tax agreements with approximately 70 countries worldwide.

III SUCCESSION

Under UAE law, inheritance is governed by UAE Federal Law No. 5 of 1985 (the Civil Code), by UAE Federal Law No. 28 of 2005 (the Personal Status Law), and, in some instances, by the DIFC Wills and Probate Registry Rules (the Probate Rules).

All inheritance matters within the UAE are dealt with by the shariah courts or the DIFC Probate Registry. The shariah courts apply principles of Islamic shariah. The DIFC Probate Registry does not.

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 other than by making use of the DIFC Probate Registry.

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.

Alternatively, non-Muslims may make use of the newly created DIFC Probate Registry. The DIFC Probate Registry allows non-Muslims who are at least 22 years of age and have assets located in the geographical limits of the Emirate of Dubai to prepare and register wills in respect of such assets. Wills registered with the DIFC Probate Registry shall be governed by and construed in accordance with the Probate Rules.

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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.

Wills intended to be registered with the DIFC Probate Registry must be drafted in accordance with the rules of the DIFC Probate Registry, which prescribe a recommended form for a will. In addition, such wills must be signed before an officer of the DIFC Probate Registry and electronically stored in the DIFC Probate Registry's system. The testator (i.e., the individual making the will) will be required to appoint one or more administrators to his or her will. The administrator shall have responsibility for distributing the assets of the testator in accordance with the terms of the will. A fee of 10,000 dirhams is payable upon registration of a will.

Once registered, the intention is that the terms of the will can be given effect to by the DIFC courts. Decisions of the DIFC court must as a matter of UAE law, be enforced by the Dubai courts. It is then anticipated that the other relevant Dubai governmental authorities (such as the Department of Economic Development in respect of assets such as company shares, or the Lands Department in respect of real property) would abide by orders ratified by the Dubai courts. It is hoped that, eventually, the various government departments will accept orders made by the DIFC courts directly (i.e., avoiding the need to get the DIFC orders ratified by the Dubai courts).

The DIFC Probate Registry is a new, and insofar untested, system. Accordingly, it remains to be seen how wills registered with the DIFC Probate Registry are in practice enforced in the Emirate of Dubai.

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 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]

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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.

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, as recently amended by UAE Federal Law No. 9 of 2014 (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;
b the concealment or disguise in any other manner of the source or origin of funds; and
c 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.

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.

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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.

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

AMJAD ALI KHAN

Afridi & Angell

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.

STUART WALKER

Afridi & Angell

Mr Walker regularly advises on financial services regulation, corporate finance, mergers and acquisitions and employment matters. Mr Walker leads the field in advising parties during Dubai Financial Services Authority (DFSA) investigations and, where necessary, negotiating settlements on their behalf. He was instructed by the first authorised firm to be fined by the DFSA, and has since gone on to advise in connection with the majority of all DFSA investigations resulting in a public outcome.

Mr Walker is the co-author of the UAE chapter of *Financial Services Regulation in the Middle East* (Oxford University Press, 2008), and has contributed articles to various publications including *International Financial Law Review*. He is a regular contributor to Euromoney's *Global Banking & Financial Policy Review*.

ABDUS SAMAD

Afridi & Angell

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 businesses.

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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