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DIFC Foundations Law and Protection of Assets

Legal Briefing (25 April 2022)

*Since the introduction of the foundation regime in the Dubai International Financial Centre ("**DIFC**"), DIFC Foundations have become a potent tool for international and regional investors to manage their wealth, protect their assets and plan their successions. Hereinbelow, we will briefly highlight the salient features of the DIFC Foundation followed by a brief analysis on the degree of protection available to the assets deposited with the DIFC Foundation.*

I. Introduction

Fiduciary structures such as trusts, and foundations are predominantly favorable and purposeful in the world of succession and wealth planning. Not only do these structures allow asset protection for future planning, but they also shield assets from claims by creditors and divorcees, whereas tax optimization and privacy are additional benefits provided by these structures, used in common law and civil jurisdictions alike. The DIFC offers a similar structure in the form of a DIFC Foundation for structuring assets within its jurisdiction.

II. Salient Features of DIFC Foundations

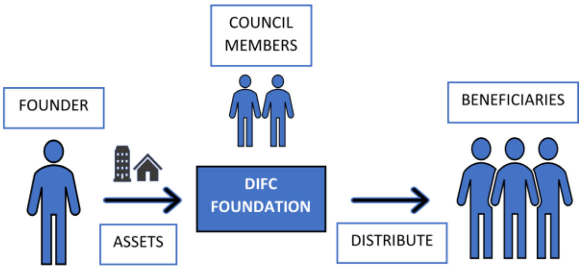
DIFC Foundations are governed by the DIFC Law No. 3 of 2018 ("**DIFC Foundations Law**"). This law came into effect in March of 2018 with the objective of providing an alternative route for the wealth management.

A DIFC Foundation is an independent legal entity that is established by a founder. The entity has a legal personality which is separable from its founder as well as its beneficiaries. The foundation differs from a company and so, it does not have any shareholders, partners or members. The entity comprises of a founder, i.e., the person that establishes the foundation, council members and beneficiaries.

The structure of DIFC Foundations is such that it is a combination of both trusts as well as private companies. However, a feature of DIFC Foundations which distinguishes it from a trust is that unlike in a trust, the council of a foundation does not owe a fiduciary duty neither to the beneficiaries nor to the founder.

In a DIFC Foundation, the founder appoints at least two council members; the council is tasked with fulfilling the objectives of the foundation. The founder can also be a council member and so can the beneficiaries. DIFC Foundations are self-owned, and must have a foundation charter which must include details such as the name of the foundation, the founder, beneficiaries, guardian (if any), objects, duration, etc.

Apart from the foundation charter, the DIFC Foundation must also have byelaws within which the duties and functions of council members must be laid down. The manner in which the assets of the foundation may be managed must also be entailed within the byelaws.



III. Benefits of the DIFC Foundations Regime

DIFC is one of the renowned and established financial centers in the world and the regime of foundations within DIFC is impeccably flexible. The flexibility in the structure of DIFC Foundations and the prominent retention of control by the founder makes DIFC Foundations an attractive option for a variety of purposes such as for the protection of assets, management of private wealth, taxation planning, succession planning, charitable purposes, and corporate structuring.

DIFC Foundations have a strong governance structure as well as an attractive 0% corporate tax rate. The mechanism of the protection of assets within the DIFC jurisdiction is sturdy. All of these reasons have led to DIFC Foundations being a sought-after vehicle for structuring and protecting assets.

IV. Asset Protection under DIFC Foundations

The most attractive feature of any fiduciary structure is that it offers an adequate protection to the assets which are deposited with it by alienating the assets from its prior ownership and associated liabilities. Similarly, DIFC Foundations Law offers protection to the assets deposited with the DIFC Foundation.

Under the DIFC Foundations Law, once the assets are deposited by the founder or a contributor to a DIFC Foundation, it becomes the property of the foundation, leaving behind no legal interest with the founder or a contributor, respectively. As DIFC Foundations are considered as a separate and standalone structure having its own legal personality, which is distinct and separable from its founder, therefore, once the asset/property is vested with the foundation, all rights and interests coupled with such property are automatically vested in the foundation and any previous right or interest in the property is effectively relinquished.

Therefore, as a matter of general principle, once the DIFC Foundation becomes an absolute owner of the assets deposited by the founder / contributor, such assets automatically become immune from any adverse actions from the adversaries/creditors of the founder / contributor (Article 14 (2) of the DIFC Foundations Law). Under the DIFC Foundations Law transfers of property to the DIFC Foundation shall furthermore not be deemed invalid by reason of claims made against the founder in his / her individual capacity. Article 14 (1) and 14 (2) of the DIFC Foundations Law provide solid protection to the assets of a foundation and can guarantee the safety of the assets. However, such a protection is not an absolute one and there exists an exception to the same, which is discussed hereinbelow.

V. Exception to Asset Protection under the DIFC Foundation Regime

In any jurisdiction, vehicles such as foundations, trusts and other fiduciary structures are sometimes misused and manipulated with the aim of defrauding creditors, money laundering and other related crimes. In order to counter such cases, the relevant jurisdictions around the globe typically apply certain exceptions to the general principle of protection of assets in the case of assets which have been illicitly transferred to the fiduciary structure. The same applies to foundations under the DIFC regime. Specifically, under the DIFC Foundations Law, such an exception is laid down in Article 14 (3). As per this provision the DIFC Courts retain the authority to declare the transfer of any asset null and void in certain situations, e.g., where the DIFC Courts are of the opinion that the transfer of the asset occurred at a time when the founder was insolvent or had the intention of defrauding creditors.

It can be understood from this provision that the property of the foundation can be declared void, voidable, set aside or it may be used to fulfill the claim of the creditors if the transfer was done with an intention of defrauding the creditors. This makes it clear that the structure of a DIFC Foundation cannot be used for illegal or illicit purposes such as defrauding creditors' claims and, in any case, the DIFC Courts retains the power to decide upon the same.

VI. Conclusion

DIFC Foundations offer a solid private wealth management solution which allows for structuring, protection of assets as well as taxation and succession. Parties interested in establishing a DIFC Foundation must carefully devise the structure of the foundation.

How can we help?

The dedicated team of legal professionals at **SCHLÜTER GRAF** can help you in the evaluation of the structure of the foundation and ascertain the potential risks to the disposition of assets to the DIFC Foundation.

For any related queries, please contact us at: dubai@schlueter-graf.com

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