ALYIANT
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ALYIANT2YOU : Regulatory Brief

FAMILY BUSINESSES AND SUCCESSION PLANNING

Introduction

The adage *'time and tide wait for none'* is not uncommon to hear from matriarchs and patriarchs of established and fast-growing diverse family businesses which may not have a formal succession plan in place for the family business or their personal assets. Often this is because focus has been on the growth of the business or because a family may view a family constitution (discussed below) to suffice and postpone having in place formal structures geared towards succession till a future point in time. With the passage of time however, an urgency tends to arise to stream line and consolidate family business assets and to clearly delineate those assets from personal assets. The aim is to have a clear path of succession to the family business and personal assets upon the happening of foreseen or unforeseen events.

Family Constitutions

A very basic definition of a family business is one that is owned or run by members of a single family. It is not uncommon for families to have in place a family constitution which defines the relationship of the family to the family business. Broadly speaking, the family constitution can be seen as a framework for setting forth the key policies of the family for the governance of the family business, encapsulating amongst other matters: the mission, vision and values of the family; the principles of the family for working together; a description of the composition and role of the family council; how the family council makes decisions (including with respect to investments, divestments and voting); defining family members rights and obligations to each other and to the family business; how conflicts will be resolved; and succession related matters for passing on the family business from one generation to another. Matters comprising the family constitution are enshrined in a formal document and which depending on the approach taken by the family, may or may not be legally binding, and may or may not provide any formal dispute resolution mechanism. Family constitutions may lack certainty and/or clarity and therefore, whilst one may be in place, for the purposes of certainty for succession planning purposes, putting in place structures towards a seamless transition of family business and personal assets from one generation to another should be a focus of a matriarch or patriarch of a family business rather than relying solely on a family constitution.

DIFC

With a preference being to have the over-arching ownership structures for business and personal assets in the same jurisdiction (even though the operating assets may be in different jurisdictions), most global business and financial centres today provide for multiple types of structures towards allaying succession concerns. In this paper, we focus on the Dubai International Financial Centre (**"DIFC"**) which offers legal structures aligned towards family businesses and succession planning. The DIFC provides for a range of legal structures to families looking for a base for all or part of the family business and put in place succession plans for business and personal assets. Options include: (i) Holding Companies; (ii) Managing Offices; (iii) Proprietary Investment Companies; (iv) Prescribed Companies; and (v) Foundations. In addition, a Single Family Office structure may be established to provide services to a Single Family. Each is discussed below. Please note, this paper does not cover any financial services activities prescribed by the applicable laws of the DIFC, which are regulated by the Dubai Financial Services Authority (**"DFSA"**) and require to be licensed by the DFSA.

Unless otherwise defined herein, any defined terms identified by the capitalization of the initial letter of a word or phrase, are defined under the applicable laws of the DIFC.

Holding Companies

A company licensed in the DIFC to carry out "Holding Company" activities envisages companies engaged in holding the securities of (or other equity interests in) companies and enterprises for the purpose of owning a controlling interest or influencing the management decisions of such companies and enterprises. Holding Company activities in the DIFC do not cover the administration, overseeing and management by the Holding Company of other companies or establishments whose securities they hold.

Managing Offices

Where in addition to holding the ownership of other companies and enterprises under a Holding Company structure, a family business wishes to administer, oversee and manage such other companies and establishments, the Holding Company may also apply to be licensed to carry out Managing Office activities. Managing Office activities in the DIFC primarily envisage undertaking the strategic or organizational planning and decision making role of companies or enterprises. This activity is extended to allow providing services strictly to its group such as, but not limited to (treasury services, IT Services, administration services, intra group corporate services and advisory). A DIFC company may be licensed to carry out Holding Company and Managing Office activities.

Proprietary Investment Companies

There are eight different types of Proprietary Investment Company license categories in the DIFC, namely: (i) Investment in Commercial Enterprises and Management; (ii) Investment in Agricultural Enterprises and Management; (iii) Investment in Educational Enterprises and Management; (iv) Investment in Healthcare Enterprises and Development; (v) Investment in Industrial Enterprises and Management; (vi) Investment in Oil and Natural Gas Projects; (vii) Investment in Retail Trade Enterprises and Management; and (viii) Investment in Real Estate. Each of the above types of "Proprietary Investment Company" categories is activity specific. For example, "Investment in Commercial Enterprises and Management" envisages entities engaged in holding their own investment portfolio and forming, managing, and investing their funds in any business or firms which carry out various commercial activities. Besides covering other investments or shareholdings in commercial enterprises, this also includes the management of such companies and the organization of their affairs. A DIFC company may be licensed to carry out the activities of a Holding Company, Managing Office and any of the category of activities of a Proprietary Investment Company.

Prescribed Companies

The Prescribed Company Regulations 2019 ("**PCR**") came in to force on 31 October 2019 in the DIFC. The Prescribed Company concept offers flexibility by enabling multiple entities with their own legal personality to be created under one over-arching entity structure. This may not only enable ring-fencing and the mitigation of risk by siloing individual business lines and investments under separate appropriately licensed entities, but may also provide value creation for businesses under one over-arching legal structure. In order to incorporate a Prescribed Company, either of the following qualifying requirements needs to be satisfied: (a) the Prescribed Company will be "Controlled" by one or more "Qualifying Applicants" or (b) the proposed Prescribed Company is to be established or continued in the DIFC for a "Qualifying Purpose". Whether to establish or continue under the qualifying requirements of a Qualifying Applicant or for a Qualifying Purpose will depend on the objectives and structuring requirements for the Prescribed Company.

The PCR defines the term "Qualifying Applicant", which in material part (for the purposes of present discussion) includes: (a) a Family Office; (b) a Foundation; (c) a Holding Company; (d) a Private Trust Company; (e) a Proprietary Investment Company; or (f) a person wholly owned by one or more of the foregoing Qualifying Applicants.

In order to incorporate a Prescribed Company under the Qualifying Applicant criteria, the Prescribed Company is required to be "Controlled" by one or more "Qualifying Applicants". The term "Control"/ "Controlled" is defined in the PCR as the power of a person to secure: (a) by means of holding of shares or the possession of voting power, in either case directly or indirectly; or (b) as a result of any powers conferred by the Articles of Association or other document regulating the Prescribed Company or any other body corporate, that the affairs of the Prescribed Company are conducted in accordance with such person's wishes.

Regarding a "Qualifying Purpose", the PCR defines the term in material part (for the purposes of present discussion) to include a "Family Holding Structure". The PCR defines a "Family Holding Structure" as "a structure of one (1) or more persons established for the sole purpose of consolidating the holdings of a specific family member, their spouse and/or bloodline descendants in a Family Office, a Holding Company or a Proprietary Investment Company.

Holding Company and Proprietary Investment Company's have been discussed above. A "Family Office" is defined by the PCR as "a Registered Person established pursuant to the Family Office Regulations that is physically present in the DIFC". The "Family Office Regulations" are with reference to the "Single Family Office Regulations" (discussed below).

The license of a Prescribed Company established by a Qualifying Applicant may include any activities permitted in accordance with the categories of commercial licenses available in the DIFC. The license of a Prescribed Company established for a Qualifying Purpose is restricted to the activities specific to the Qualifying Purpose stated in its application to incorporate or continue the Prescribed Company in the DIFC. It should be noted that a Prescribed Company cannot provide any Financial Service (defined in the PCR as: any financial activity prescribed by applicable law in the DIFC or a Recognised Jurisdiction (also defined in the PCR) as constituting a financial service) unless it is authorised by the DFSA to do so.

Foundations

By way of back-drop, the DIFC has in place an advanced legal framework for trust structures in terms of the Trust Law 2018 (DIFC Law No.4 of 2018). However, handing over by a settlor of control of assets and wealth to a professional trustee who then becomes the legal owner (even though such a trustee would not be the beneficial owner) can be of considerable concern and may pose a dilemma to matriarchs and patriarchs of a family business. In addition to handing over control of assets and wealth, such settlors may harbour concerns that professional trustees of the trust may not understand the nature of the businesses owned by the trust and/or what is in the best interests of the beneficiaries of the trust. Whilst to mitigate these concerns, the option in the DIFC is available for the establishment of a 'Private Trust Company' prescribed by and subject to applicable criteria under the applicable laws of the DIFC, a DIFC Foundation provides for a single wholesome and flexible structure for succession planning of business and personal assets.

Nature of a Foundation

Foundations in the DIFC are regulated by the Foundations Law 2018 (DIFC Law No.3 of 2018) (**"Foundations Law"**). The nature of a Foundation is described by the Foundations Law and includes the following: (i) it is a corporate body with a legal personality separate from that of its Founder(s) and any other person; (ii) the property of a Foundation is not held by it upon trust for any other person; (iii) a Foundation has the capacity, rights and privileges of a natural person; (iv) a Founder has such rights (if any) in respect of a Foundation as provided for in its By-laws; (v) a person specified in the By-laws (other than a Founder, a member of the Council, the Registered Agent and any Guardian) has such rights (if any) in respect of the Foundation as provided for in its By-laws; (vi) any rights a person may have in respect of a Foundation maybe assigned to some other person, if its By-laws so provide and subject to the provisions of the Foundations Law.

Who is a "Founder"?

A "Founder" is a person who contributes property to a Foundation in order to establish it under the Foundations Law.

Duration of a Foundation

In terms of the Foundations Law, a Foundation may but need not be established for a fixed period or for a specified limited period. However, a Foundation may be dissolved at an earlier time in accordance with the provisions of the Foundations Law.

Objects of a Foundation

A Foundations objects: (i) must be certain, reasonable and possible; and (ii) must not be unlawful or contrary to public policy in the DIFC. A Foundation may be established for: (i) objects which are exclusively charitable; or (ii) one or more of the following: (a) objects which are not exclusively charitable; or (b) objects to benefit persons by name, category or class. It is sufficient for the Charter of the Foundation to provide that a Foundation is to hold property selected in accordance with its By-laws where the objects of the Foundation are not exclusively charitable. Where the objects of the Foundation are to benefit persons by name, category or class, it is sufficient for the Charter of the Foundation to provide that a person or class of persons to receive benefits may be determined in accordance with its By-laws. A Foundation may not carry out any commercial activities, except those which are necessary for and ancillary or incidental to its objects.

Property of a Foundation

Capital endowment: The initial capital of a Foundation is the capital endowed upon the Foundation in order that the Foundation may be established. Such initial capital may comprise any property, and may be provided by way of gift or for valuable consideration. Following the endowment of the initial capital, further property may be endowed upon the Foundation by any person if the Charter of the Foundation so permits.

Financial Resources: In terms of the Foundations Law, the property of a Foundation is to consist of: (i) the initial capital of the Foundation; (ii) any further amount endowed upon the Foundation and accepted by its Council; (iii) the proceeds of investment of the capital of the Foundation; and (iv) any other property acquired by its Council in accordance with the Foundations Law.
Qualified Recipients: A Foundation's By-laws may provide for the distribution of property of the Foundation to "Qualified Recipients". A Qualified Recipient is one or more of the following: (i) a person holding an entitlement specified in, or pursuant to, the By-laws to a fixed share of the property and income of the Foundation when the Foundation distributes it; (ii) a person holding a depository receipt (details of which are provided for in the Foundations Law); (iii) a person who is a prospective recipient of a fixed, or discretionary, share of the property of the Foundation upon the happening of a future event specified in the By-laws; (iv) a person who is nominated pursuant to the By-laws to be a recipient of a fixed, or discretionary share of the property and income of the Foundation at a time following the establishment of the Foundation; (v) a charity; and (vi) a default recipient (details of which are provided for in the Foundations Law).

Reservation to Founder of Powers to amend, revoke, vary or terminate: In terms of the Foundations Law, a Founder may reserve the following powers: (i) a power to amend, revoke or vary the terms of the Charter or By-laws, or both of them, in whole or in part; (ii) a power to amend, revoke or vary the objects of the Foundation, in whole or in part; and (iii) a power to terminate the Foundation, provided that the power to amend, revoke, vary or terminate, as the case may be, is detailed in full in the Charter, and provided that these powers are only reserved: (a) for a period not exceeding the duration of a Founder's life, if he is a natural person; or (b) for a period not exceeding fifty (50) years from the date of establishment of the Foundation, if the Founder is a legal person, and thereafter any such powers so reserved lapses, notwithstanding the terms of the Charter. If any power above has been reserved to more than one Founder; and more than one Founder is capable of exercising it at that time, then such power must be exercised by those Founders unanimously unless the Charter provides otherwise.

Non-Voidability of Foundation: In terms of the Foundations Law, no disposition of property to a Foundation that is valid under the laws of the DIFC is void, voidable, liable to be set aside or defective in any manner by reference to a Foreign Law (i.e. any law other than DIFC law); nor is the capacity of any Founder in relation to the Foundation or disposition to be questioned nor is the Foundation or any other person to be subjected to any liability or deprived of any power or right, by reason that: (i) the laws of any foreign jurisdiction prohibit or do not recognise the concept of a foundation; (ii) the disposition voids or defeats any rights, claims or interests conferred by Foreign Law upon any person by reason of a Personal Relationship (as defined in the Foundations Law) to a founder or any other person related to the foundation or by way of Heirship Rights (as defined in the Foundations Law) or contravenes any rule of Foreign Law or any foreign, judicial or administrative order, arbitration award or action intended to recognise, protect, enforce or give effect to any such rights, claims or interests; or (iii) the Foreign Law or foreign judicial or administrative order or arbitration award imposes any obligation or liability on a founder, foundation or any other party in relation to the foundation or the property of the foundation. Under the Foundations Law, a transfer of property to a Foundation is not void, voidable or liable to be set aside by reason of a Founder or Contributor's (i.e. a person other than a Founder who contributes property to the Foundation) bankruptcy, the liquidation of a Founder or Contributor, or any action or claims made against a Founder or Contributor by any creditor, notwithstanding any foreign statute providing otherwise. The above is subject to a proviso that, where the Court (i.e. the DIFC Courts) determines that at the time when the property was transferred to a Foundation, a Founder or Contributor, as applicable, was insolvent or intended to defraud any creditor of a Founder or Contributor, as applicable, it may declare that the transfer of property was void to the extent of the creditor's claim.

Continuation of a Foreign Foundations in the DIFC: In addition to the Foundations Law providing for the establishment of a Foundation, it also makes provision for the transfer of a Foreign Foundation to the DIFC. A Foreign Foundation is an entity that: (a) is organised in a jurisdiction other than the DIFC; and (b) has characteristics that would, if it were in the DIFC, enable it to be established as a Foundation under the Foundations Law. A Foreign Foundation may, if it is not prohibited in terms of its founding documents or under the laws of the jurisdiction under which it is organised, apply to the DIFC Registrar of Companies for a certificate of continuation under the Foundations Law. Subject to completion of the process under the Foundations Law, when a Foreign Foundation is continued as a Foundation in the DIFC under the Foundations Law: (i) the property of the Foreign Foundation becomes the property of the Foundation; (ii) the Foundation continues to be liable for the obligation of the Foreign Foundation; (iii) an existing cause of action, claim or liability to prosecute is unaffected; (iv) a civil, criminal or administrative action or proceeding pending by or against the Foreign Foundation may be continued by or against the Foundation; and (v) a conviction against, or ruling, order, or judgment against or in favour of, the Foreign Foundation may be enforced against the Foundation.

Recognised Foreign Foundations: Under the Foundations Law, a Foreign Foundation wishing to conduct operations in the DIFC may apply for a license to be a Recognised Foreign Foundation (i.e. a branch of a Foreign Foundation) in the DIFC and comply with the requirements specified in the Foundations Law to do so.

Single Family Offices

Generally, a traditional Single Family Office is a business run by and for a single family and its sole function is to centralize the management of a significant family fortune. The family office invests the family's money, manages all of the family's assets, and disburses payments to family members as required. In addition to investment management, some Single Family Offices may provide personal services such as making travel arrangements, property management, day-to-day accounting and payroll activities, and family management services, including family governance, financial and investment education, and succession planning. These organizations employ staff to manage the requirements and services of the family office.

SFO Regulations: Single Family Offices in the DIFC are regulated by the Single Family Office Regulations 2011 (**"SFO Regulations"**). The SFO Regulations apply to: (a) every Person who falls within the definition of a Single Family Office; (b) persons applying for the registration of a company or partnership to act as a Single Family Office (**"SFO"**) or Private Trust Company (referred above); or (c) the DIFC Registrar of Companies. In terms of the SFO Regulations, a SFO means any Body Corporate or Partnership established within the DIFC providing services only to a Single Family. A Single Family must have minimum investable/liquid assets of US$10 million. For the purpose of determining investable/liquid assets, only those assets which are realisable in a 180 day period should be considered.

Single Family: 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 DIFC Registrar of Companies. With respect to determining a Single Family common ancestor, regard may only be had to the preceding three generations of the family in question. In relation to a Single Family, a "Family Member" means an individual forming part of the group of individuals comprising the Single Family. The SFO Regulations also envisage both male and female members of a family to be included in the Single Family and that individuals adopted as minors, step children, children of adopted children and illegitimate children of a qualifying family member to also be regarded as members of the Single Family.

Services: The provision of services to a Single Family under the SFO Regulations cover: (a) the provision of services to one or more Family Members; (b) the provision of services to a Family Fiduciary Structure; (c) the provision of services to a Family Entity; or (d) the provision of services to a Family Business. The SFO Regulations specify the following categories of services to be provided by the SFO: investment; fiduciary; accounting; philanthropic; concierge; governance; and other.

"Family Fiduciary Structure": In relation to a Single Family, a "Family Fiduciary Structure" is a trust or other similar entity (such as a foundation): (a) of which a Family Member of a Single Family or a Family Entity related to the Single Family is the settler or founder; and; (b) the beneficiaries of which, or persons otherwise capable of benefiting from which, are all: (i) Family Members; (ii) charities; (iii) Family Entities; or (iv) other Family Fiduciary Structures related to the Single Family.

"Family Entity": In relation to a Single Family, a "Family Entity" is an entity such as a Body Corporate or Partnership controlled by a Single Family within the meaning of the SFO Regulations.

"Family Business": In relation to a Single Family, a "Family Business" is a business whether a Body Corporate or Partnership controlled by a Single Family within the meaning of the SFO Regulations.

Control: Regarding the above references to 'controlled', the SFO Regulations defines the term "control" and provides that a Family Entity or a Family Business is controlled for the purposes of the relevant SFO Regulations if any of the following, acting alone or together, could exercise at least 75% of the voting control, or are otherwise able to exercise direct or indirect control over the affairs of the Family Entity or a Family Business (having the right to appoint or remove the equivalent of 75% of the board of directors or managers of the entity in question): (a) one or more Family Members; or (b) one or more Family Fiduciary Structures; or (c) one or more Family Entities; or (d) by a combination of any of them.

Non DIFC entities: Under the SFO Regulations, a SFO or personnel of the SFO acting as directors of a Family Fiduciary Structures, Family Entities, Family Businesses or Private Trust Companies established outside the DIFC and/or management and control of such entities may take place in or from the DIFC.

Transfer of Incorporation

As part of a structuring for succession planning purposes, where a family business with business operations under a "Foreign Company" (i.e. a body corporate incorporated in any jurisdiction other than the DIFC) determines that the DIFC is most appropriate for its business operations and wishes to redomicile the Foreign Company, it would ideally look to such redomiciliation without losing the history and goodwill it may have built up over the course of time as well as seeking to ensure that its existing rights and obligations continue uninterrupted. This may be possible where an entity is able to redomicile or transfer its incorporation from one jurisdiction to another under applicable provisions of law. Matters pertaining to the transfer of incorporation from another jurisdiction to the DIFC is governed by the DIFC Companies Law 2018 (DIFC Law No.5 of 2018) ("**Companies Law**") and the DIFC Companies Regulations (in force on 12 November 2018) ("**Companies Regulations**").

The Companies Law and the Companies Regulations prescribe the procedure for a Foreign Company to continue as a Company (i.e. a Private Company or a Public Company) in the DIFC. A Foreign Company may, if authorised by the laws of the jurisdiction in which it is incorporated, apply to the DIFC Registrar of Companies for the continuation of the Foreign Company as a Company in the DIFC. Subject to completion of the procedure prescribed for continuation of Foreign Company as a Company under the Companies Law and Companies Regulations, then where such Foreign Company is continued as a Company under the Companies Law, the Company: (a) continues to have all the property, rights and privileges and is subject to all the liabilities, restrictions and debts that it had before the continuation; and (b) remains a party in any legal proceedings commenced in any jurisdiction in which it was a party before the continuation.

Conclusion

The DIFC provides for a diverse range of structures that can be established under one jurisdiction for the purposes of the succession planning and operations of family businesses as well as for personal assets. The above are several of the options available in the DIFC. As to whether the DIFC is the appropriate jurisdiction for housing a family business and so as to arrive at the optimal structures and jurisdiction for succession planning and operational purposes, will depend on the dynamics of each family and family business involving the determination of a number of factors, including: the type of assets involved; the location of the assets; the location of businesses; location of family members; tax considerations; and costs of establishing and maintaining the legal structures.

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