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Understanding Sharia'a Compliant Trusts...in Guernsey and Beyond

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Sharia'a compliant trusts have seen a recent increase in popularity, evidenced by the creation of trusts laws in both Dubai and Bahrain in 2007, although offshore jurisdictions such as Guernsey continue to be a popular choice for creating and administering Sharia'a compliant trusts. This is due to a number of reasons including Guernsey's history and experience as a trust jurisdiction and Guernsey's state of the art Trusts law.

To understand and appreciate the use of Sharia'a compliant trusts, one must first understand what the Sharia'a is. The Sharia'a is the divine law of Islam as derived from the Quran and Sunnah¹ and also Qiyaas and Ijma². It is not a code of law like English law for example, but rather a set of rules which govern how Muslims (followers of Islam) conduct their daily lives.

The Sharia'a encourages investment and increasing wealth, provided this is carried out in a Sharia'a compliant manner i.e. accords to the following three principles:-

1. Charitable principles - A certain amount of wealth is passed to charity;
2. Substantive principles – One does not invest in Haram (prohibited) investments³; and
3. Procedural principles – The investment does not involve Riba⁴ (interest/excess), Gharar (uncertainty), Maysir (speculation) and does not infringe forced heirship rights⁵.

Whilst "the trust" is a concept developed by the English Courts of Equity that dates back to the time of the crusades, having perhaps been inspired by the Roman fideicommissum⁶, there is a concept under Islamic law known as the "waqf" which has many similarities to a trust which dates back to at least the 10th century. In essence the Waqf was either a family or charitable endowment of property, created by a donor for use by designated beneficiaries and administered by trustees who in turn were under the supervision of a local judge.

¹ The Quran is the text of Allah delivered to the Prophet Mohammed, and the Sunnah is the acts and words of the Prophet.

² Qiyaas is an analogy of Islamic Scholars and Ijma is the consensus of a majority of Islamic Scholars which becomes part of the Sharia'a

³ Haram investments include:- Pork, alcohol, adult entertainment, gambling, conventional financial products, defence, tobacco etc

⁴ The prohibition against interest is referred to in the Quran a number of times including in 2:275:- "*Those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness*". Interestingly, reference can also be found a number of times in the Bible including in *Deuteronomy 23:19* - "*Do not charge your brother interest, whether on money or food or anything else that may earn interest.*"

⁵ Sharia'a has a complex and rigid system of legal rules which provide for a deceased person's estate to be apportioned among certain close relatives in definite fixed shares. This system of **forced heirship** applies generally to at least two-thirds of a person's estate. The particular importance of the Islamic laws of inheritance is obvious from the verses immediately following those verses giving specific details on inheritance shares, "*These are limits (set by) Allah (or ordinances as regards laws of inheritance), and whosoever obeys Allah and His Messenger will be admitted to Gardens under which rivers flow (in Paradise), to abide therein, and that will be the great success. And whosoever disobeys Allah and His Messenger, and transgresses His limits, He will cast him into the Fire, to abide therein; and he shall have a disgraceful torment.*" [Quran 4:13-14]

⁶ The **fideicommissum** permitted a testator to demise his property to a legally incapable beneficiary by transmitting it to a capable legatee responsible for fulfilling his promise to deliver the property to the incapable (and otherwise ineligible) beneficiary.

With the Islamic Finance Industry consisting of any where between \$500billion - \$1 trillion and a growth rate of approximately 15-20% per annum, it is clear that there are a large number of wealthy Muslims who wish their business activities to be conducted in a Sharia'a compliant manner. Many of these Middle Eastern persons are becoming increasingly interested in the use of trusts as a means of asset protection and ensuring family wealth remains available for the benefit of future generations. However, such trusts will need to adhere to the Sharia'a.

For a trust to be Sharia'a compliant, one must comply with the principles highlighted above and in particular, focus upon (1) the restrictions on investment and (2) the Islamic rules of inheritance:-

1. Trust investments – Ensuring the trust fund is not invested in Halal investments

Although a trust instrument usually contains very wide powers of investment, it could be drafted so as to restrict investments to those that are Halal (acceptable under Sharia'a law). With regard to choosing investments for a trust, in the absence of an investment trust committee with expertise in Sharia'a investments, trustees will often employ the services of investment managers who in turn will employ the services of Sharia'a Scholars to advise on compliant investments. In addition to checking the investment to be held directly, the underlying business/activity of the investment also needs to be screened, for example, a holding of shares in a hotel is Sharia'a compliant, but not if the hotel operates a casino, sells alcohol, hires it out for wine tasting etc. Likewise the holding of land or buildings should be Sharia'a compliant, but not where tenants are engaged in activities that are prohibited such as running a brothel or selling pork. Whilst an investment trust committee may be suitable for some trusts, the use of protectors is common in many Sharia'a compliant trusts. A protector can be a person or group of persons such as a family council, whose consent is required for certain specified actions by the trustees such as investment, distributions of trust assets and appointment of new trustees. The protector provides reassurance to the settlor and his family, particularly where the family have not had a prior relationship with the trustees⁷.

2. Inheritance – Ensuring the trust does not infringe the forced heirship rules

As referred to above, Islam has complex forced heirship rules for the division of inheritance set out in the Quran which must not be infringed notwithstanding there are no restrictions under the Sharia'a in relation to lifetime gifts. There are two ways of ensuring this in drafting the trust:-

1. A settlor who wants to create a trust, the beneficial provisions of which are strictly Sharia'a compliant, may require a trust which provides that on his death the trust fund is to be paid to his heirs under Sharia'a law in the proportions set out in the Qur'an. In order to determine the shares into which the trust fund should be split, the trust could be drafted to provide that the trustees are to consult with the protector or a Sharia'a Scholar and once the shares have been ascertained, those shares would then be paid to the beneficiaries. The problem with this is that the trust would end on the settlor's death and its usefulness in terms of asset protection and wealth preservation would potentially be lost.

2. A fully discretionary trust could be used for settlors motivated to preserve assets for the benefit of future generations, whilst nevertheless having regard to the Sharia'a inheritance proportions (at least in relation to those assets located in an Islamic jurisdiction). With such a trust, the trustees may, in exercising their discretion as to distributions, have regard to a letter or memorandum of wishes from the settlor, such letter or memorandum being non-binding upon the trustees. In such a letter or memorandum, the settlor may set out how he wishes the trust fund to be used upon his death i.e. when making payments to family members, taking into account amounts that the various heirs under Sharia'a law may have already received, thus ensuring that no heir receives more than their

⁷ Care should be taken with regard to (i) choice of a protector(s) - someone who understands the Sharia'a and is not likely to use their powers to the detriment of the beneficiaries, for example the settlor's spouse may in the event of divorce from the settlor, exercise their power not in the beneficiaries best interests, also whether or not the protectors' powers are to be classified in the trust instrument as fiduciary as opposed to personal; (2) ensuring that the protector provisions do not make the administration of the trust unduly complicated; (3) where there is more than one protector, whether the protectors are to act unanimously or by majority, the former potentially paralysing the administration of the trust in the event the protectors do not agree.

entitlement under the Sharia'a. Alternatively the letter or memorandum may more strictly divide the trust fund into sub-funds in amounts determined by reference to the heirs' entitlement but retained by the trustees with discretion as to when and how much is paid to the beneficiaries. The settlor may also state he would like the trustees to be consulted for advice on Sharia'a law matters, and/or request the trustees to make certain annual payments to, for example, the settlor during his lifetime in order that he makes a distribution of Zakat⁸ to worthy causes.

To the extent that any trust is not fully-Sharia'a compliant, care should be taken to ensure that assets are not held within a jurisdiction subject to Sharia'a law as the local courts may well decide to apply Sharia'a rules to assets within their jurisdiction, irrespective of the intended legal effect of the structure in which they are held.

The Future of Sharia'a Trusts

Following the growth in the wealth of a number of Islamic states, driven by high oil prices, and the long established use of the Waqf, the trust is a concept being increasingly used by Muslims concerned with asset protection and ensuring that family wealth remains available for the benefit of future generations whilst at the same time respecting the Sharia'a.

Often Middle Eastern clients chose to set up trusts outside Islamic countries for a number of reasons including to take advantage of established trust laws and the wealth of trust experience of offshore jurisdictions such as Guernsey and the opportunity to settle assets in a mixture of a Sharia'a and non-Sharia'a compliant manner.

⁸ Zakat is an obligatory tax on Muslims charged at 2.5% per lunar year