

In the name of the Allah, The Beneficent, The Merciful

Instructions to Al Qalam on the matter on interest-bearing loans to oneself and other family members from one's own trust.

Background

Al Qalam Shariah counsel is respectfully requested to advise on a number of specific situations which involve interest being paid on loans being made to a UK Muslim from his/her own Trust. Advice should also extend to loans being made to other family members. By way of background, some information is presented below on Trusts in English Law and Tax strategies.

Trusts, Trustees & Beneficiaries in English Law

English Law accepts asset ownership under a Trust. The key parties to a Trust are the Trustees and the beneficiaries. The Trustees normally hold legal title over the assets of the Trust and are charged with responsibility of ensuring these assets are utilised in the interests of the beneficiaries. The beneficiaries are those in the eyes of the law intended to benefit from the assets of the Trust.

For the purposes of background information, there are 2 main types of Trusts; Discretionary Trusts and Interest in Possession Trusts.

1) Discretionary Trust – This is one where the various classes of beneficiaries are pre-determined (eg parents, children etc); however, they can only benefit at the discretion of the Trustees. As such, the trustees have full power in determining which of the beneficiaries stands to benefit, and by how much.

An example of this is where a father places funds into a Trust for the educational benefit of his children. Expenses incurred for the children's educational needs are paid for from the trust. The father is the Trustee and the children are the beneficiaries. The father has total decision-making power over which child's expenses are paid for and which ones are not.

2) Interest in Possession Trust (IIP) – This type of Trust works in a manner in which the nominated Life Tenant has a right to all income during their life. Upon the life tenant's death, the capital of the trust is distributed amongst pre-determined beneficiaries known as the remainder-men. In this type of Trust the sole beneficiary of the Trust during life is the Life Tenant. Only on death do the remaining beneficiaries claim a stake of the assets.

An example of this trust would be where a husband places a property in trust for his family. His wife is nominated as the life tenant and as such during her life she is entitled to all the rental income from the property whilst on her death her children will become the beneficiaries of the actual property.

USES OF TRUSTS

There are various uses of Trusts in the UK. 2 of the most frequent are asset protection and tax mitigation. Asset protection can be achieved by virtue of a father settling an asset into a trust in favour of his son. The father may choose this route instead of gifting the asset to his son directly, as this would prevent the son selling the asset and squandering the proceeds. In this scenario, the father would be the trustee of the Trust and the son the beneficiary. The father would determine how the son benefited from the Trust whilst the son as a beneficiary would have no legal ownership over the asset.

The second of the 2 purposes cited above is tax mitigation. In the UK an individual drawing funds from a company normally has 2 routes, firstly to take the funds as salary or secondly to take a dividend. Neither route is particularly attractive from a taxation perspective, especially for higher rate tax-payers, as both avenues result in an approximate 50% tax rate. Thereby for every £2 earned, £1 goes to the tax authorities.

An alternative route to both options above is for the individual's company to first create a trust and then pass his intended remuneration proceeds into the Trust. He can then loan those funds to himself. As he is loaning funds to himself instead of paying salary/dividends, the entire loan amount is tax-free. He is free to utilise these funds in any way, shape or form he wishes. UK Tax law however stipulates that the borrower must pay interest at 6.25% on the outstanding loan (albeit to his own trust). In the eyes of the law, he is borrowing funds in his personal capacity from a Trust which has an independent legal identity.

A number of questions follow from the scenario above which Shariah Counsel is respectfully requested to advise upon;

- 1) Assuming the owners of the company passing funds into the Trust (for tax benefit) are the same people receiving the funds as a loan out of the trust, then is the payment of interest on that loan back to their own trust permissible from a shariah perspective. Does the repayment of the interest fall within the ambit of Riba as defined in the Qur'an and Sunnah.
- 2) If the wife of the individual mentioned in question 1 above receives the loan rather than the individual themselves (due to tax law in some circumstances preventing the individual from receiving a loan), then does interest paid by the wife on that loan to her fall within the ambit of Riba. It is entirely possible that the wife may simply pass on to her husband, the funds loaned from the trust and indeed that the husband effectively pays the interest on behalf of the wife. As such, the wife is arguably an agent through whom (due to tax law) all loans are being made and all repayments occurring. Does therefore the repayment of the interest by the wife fall within the ambit of Riba as defined in the Qur'an and Sunnah.
- 3) If a borrower in the scenarios above fails to make an interest payment back to the Trust then the Tax Authorities levy a tax charge on the individual for **not paying** the interest. So for example on a £100,000, the normal amount of interest due would be £6,250. If the individual does not pay this then 40% of this amount

£2,500 is payable as tax due on not having paid the interest. Does Shariah Counsel feel that this option is preferable above the options mentioned in points 1 & 2 above.

- 4) How are the funds held within the Trust to be regarded if the owner of the company passing funds into the Trust passes away? Are the funds to be distributed to his heirs in accordance with shariah laws of inheritance? Legally the assets form part of the individual's estate according to UK law. The nature of the Trust means that the funds continue to be used for the benefit of the company's employees for 80 years.

Jazakallaho Khairan

Subsequent question from Al Qalam panel:

Please provide clarification for the following:

1. When the owners of the company pass funds into the Trust are the funds jointly owned by the shareholders in a 'joint pot' or does each shareholder have a separate account? How does it work exactly? Then is the interest paid to all the owners jointly or is it paid only to the one making the deposit? It is important that the exact nature of the trust is determined.
2. Is it possible to create a Trust for the benefit of each share shareholder individually?

Reply:

1. The settlors placing money into the trust and the beneficiaries who receive the money will be identical in practice. In theory, there will be a wider range of beneficiaries. The most common example is that of a trading company. The settlors would be the shareholders, but the class of beneficiaries would be all employees and their family members. However, in practice the money will be used to benefit only the employees who are also shareholders, in proportion to their shareholding.
2. In many trusts, sub trusts will be created where money will be ear marked for each settlor. The interest paid on loans will then be paid directly into this sub trust. Even if a sub trust is not created, the trustees would segregate the interest money to each shareholder according to their ownership
3. The trustees are not under any legal obligation to follow the above. However, in practice they will follow any request made by the settlor as long as they do not compromise their fiduciary duty.



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الجواب حامدًا و مصليًا و منه الصدق و الصواب

According to the details supplied above:

1. If the shareholder of the company is both the settlor and the beneficiary of the Trust, whether this is through the mechanism of a generic trust with funds apportioned to individual shareholders or through the mechanism of a sub-trust for each individual, the payment of what is termed 'interest' back to one's apportioned share or sub-trust does not constitute *riba*, and is thus permitted. According to Shari'ah, such a structure only provides for the transfer of funds from one vessel owned by the individual into another owned by the same. It is not a loan contract on which interest is being paid.
2. If the wife of the shareholder contracts to receive a loan in her personal capacity from her husband's Trust with an agreement to repay the loan with interest, it is not permitted for her to do so. Any payment made beyond the principal will constitute *riba* even if it is paid by the husband on behalf of his wife. However, if the wife of the shareholder does not receive the loan in her personal capacity but in her capacity as her husband's agent, whether disclosed or undisclosed, any payment by her husband of what is termed interest to his Trust will not constitute *riba*.
3. In the situations that a husband is effectively paying 'interest' to himself, he is not obliged to choose between paying the relevant rate [6.25%] of 'interest' on his 'loan' and between paying 40% tax on the rate of interest payable, as the former does not constitute *riba*.
4. If the owner of the company passing funds into the Trust passes away, the funds held by the Trust will constitute a portion of his estate and should be distributed amongst his heirs in accordance with Islamic law.

And Allah knows best

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