THESIS WRITING COMPETITION 2018 STEP LatAm Conference (Mexico)

Use of Trusts/Fideicomisos for Succession Planning in a LatAm Jurisdiction

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The origins of the legal institute of the "trust" lie in the medieval Great Britain. And it could not be different, since they derive from the conquests of the land of Britain by the Barbarians and the subsequent continental wars and Crusades.

In the first phase, as a preliminary institute, we have the "tenures", the legal instrument that made possible for the conqueror kings to distribute the conquered lands without losing their property. The "*tenants*" – those who were granted with a tenure by the king, could, by their turn, appoint new tenants, creating a chain of suzerains and vassals.

In the second phase, with warriors leaving properties and families behind in order to fight all over Europe, the tenure had to evolve to encompass situations faced by family fathers: how to ensure the protection of the family's wealth during their absence and – worse – in case of their death? In this context, the institute of "use" was recognized. It allowed the use of a given property by a person appointed by the owner, who could employ such property at his own discretion, subject to a few limits imposed by the Common Law. As this system showed itself not sufficient to generate the confidence needed between owners and fiduciary parties, Law had to evolve again, providing parties with a new legal instrument sufficiently safe. And the Anglo-Saxon case law did it by forging a new institute with a name that represented its own goal: the *trusts*.

By the means of a *trust*, an asset – or a group of assets – is managed by a formal tenant (called "trustee"), in the benefit of a third party (the "beneficiary"), pursuant to rules previously established by their owner (the "Settlor"). This way, the right of property was for the first time accepted to be deemed "dual". This was inconceivable from a Civil – or Roman – Law perspective, which designed the right of property as an "*erga omnes*" right, absolute, exclusive and plain, *i.e.* a right effective against any third parties concentrating different rights within itself. Not by chance, Article 1,228 of the Brazilian Civil Code (Law No. 10,406, dated January 10, 2002), sets forth that "*the*

owner has the right to use, benefit from, and dispose the thing owned, and the right to retrieve it from whoever unfairly possesses or holds it".[1]

This feature of the property right in the Civil Law generates difficulties for trusts to be understood and, therefore, recognized in Latin American jurisdictions. Since beneficiaries have a beneficial interest in the assets held under trusts because they are entitled to the income or capital from those assets, most lecturers tend to construe the legal relationship between trustees and beneficiaries as a contractual obligation between two parties, but not as an *in rem* right of the beneficiaries over the assets. However, as an example of the "dual property" system established by trust law, it is known that trust assets form a separate estate protected from the claims of the trustee's private creditors – since they are held in the benefit of third parties. However, there are still controversies about this aspect of trusts even within the Common Law doctrine. According to HONORÉ (2008), "*the beneficiary's protection consists in the right to exclude the trustee's private creditors, a right which can hardly be construed as a property right*".[2]

Furthermore, in Civil law systems, the right to property is ruled by the principle of *numerus clausus*, pursuant to which it is necessary for all new kinds of property rights to be introduced and regulated by the legislator, in line with the rules previously set forth in their respective Civil Codes. The creation of new types or rules applicable to property cannot be privately established, even without affecting third parties' interests. This is an essential difference between real rights and the legal discipline of contracts and obligations (which can be freely determined by the parties as a result of the guaranteed freedom of contract). On the other hand, such freedom does not apply to the definition of real or *in rem* rights and property relations.[3]

In the Contemporary Age, property and wealth can be easily managed despite of boundaries and distance. Financial transactions can be handled through pocket electronic devices and professional bankers are available to meet their clients' orders by means of a simple e-mail or text message. Even in this context, trusts survive as a useful and helpful legal institute, widely used by families over the world. This phenomenon is due to the discovery of the "wealth planning" as a new purpose for the use of trusts. Financial institutions and professional managers specialized themselves in providing

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[1] Original wording: "*Art. 1.228. O proprietário tem a faculdade de usar, gozar e dispor da coisa, e o direito de reavê-la do poder de quem quer que injustamente a possua ou detenha.*"

[2] Honoré, Tony, On Fitting Trusts into Civil Law Jurisdictions. Oxford Legal Studies Research Paper No. 27/2008. Available at SSRN:
<https://ssrn.com/abstract=1270179 or http://dx.doi.org/10.2139/ssrn.1270179>. Last accessed on May 26, 2018.

[3] BANAKAS, Stathis. *Understanding Trusts: A Comparative View of Property Rights in Europe*. University of East Anglia. InDret – Revista para el Análisis Del Derecho. No. 323. Barcelona, 2006. Page 5.

investment advisory and, therefore, with the needed skills to act as the "modern" trustees.

Trust became, thus, an attractive way for families to delegate and optimize the management of wealth and also to ensure the continuity of such wealth throughout the next generations. Many times, due to the volatility of markets or lack of professional skills of the generations to come, "settlors" seek wealth protection by means of trusts in view of a risk against which only trusts could be effective: their heirs themselves.

Latin American families could not be different. Living in countries with Portuguese and Spanish colonization, which focused in extractive activities instead of establishing a peopling policy, many immigrant families found an environment propitious to enrichment but at the same time a legal system lacking of legal certainty. Such families became then the perfect recipients for the institute of trusts.

In this scenario, many genuine worries started to arise, such as (i) how would local tax authorities construe the rights of beneficiaries under a trust deed?; (ii) how would local courts apply the succession and inheritance laws on the transmission of assets held by trustees?; and (iii) how would foreign exchange authorities regulate the inflows and outflows of funds from and to a trustee based abroad?

The only way to answer such questions is to, cautiously, fit each of the aspects of trusts in the national legal institutes, and then analyze the feasibility, advantages and disadvantages of using trusts as for succession planning in Latin American jurisdictions.

The first well-known Civil Law legal institute that comes to mind when comparing those available to trusts used for succession purposes is the "donation" or "gift". This because, by using a trustee as an "intermediate entity", it is possible to admit that a donation starts in the moment of the settlement of a trust and ends when the trustee transfers the assets to the beneficiaries. At this moment, there is not even the need of the settlor to be alive, because he is not the party who performs the legal act of the transmission, but the trustee. On the other hand, it is not possible to admit that at the final moment the assets are still part of the settlor's estate – they ceased to be at the moment of the settlement of the trust. With the distribution of assets to the beneficiaries, what happens is the accomplishment of the initial donation, through an action by the trustee (as intermediate).

The transmission of assets held under trusts to the relevant beneficiaries shall occur independently from the legal partition and succession proceedings happening in the jurisdiction where the settlor is domiciled. However, in Brazil, as in most of Civil Law countries, it is forbidden to heirs to omit their receipt in the succession process, thus unbalancing the proportion of distribution of assets prescribed by law and/or by the

will of the deceased. Pursuant to Article 1,995 of the Brazilian Civil Code,[4] even if the omitted assets are held abroad and, therefore, unreachable to the Brazilian courts enforcement, heirs who omit their receipt may be obliged to compensate the other heirs and then to reestablish the legal balance of inheritance.

Rules for the protection of heirs in Brazil seek either to restrict a person's ability to (i) make certain donation during her lifetime, either because they are detrimental to certain heirs or because minimum means of subsistence are not reserved to donor; and (ii) to deprive certain heirs of a minimum part of the estate upon death.

The restrictions on lifetime donations are contained in article 549 of the Brazilian Civil Code,[5] pursuant to which a person cannot donate more than the share of its wealth that it could freely dispose of under Brazilian forced heirship rules. Such part is one half of total wealth under article 1,846 of the Brazilian Civil Code.[6]

Brazilian law also forbids donations by living persons from being made whenever their amount and extent would impair de means of livelihood of the donor (article 548 of the Brazilian Civil Code).[7]

As to the second provision, it refers to transfers upon death of a person. In this case, her spouse, children or ancestors cannot be deprived by will or any other act of more than half of the persons estate at the moment of death (articles 1845 and 1846 of the Brazilian Civil Code). All these aspects shall be considered by a Brazilian judge when ruling any matters regarding involving trusts.

Talking about enforcement of trusts by Brazilian courts, it is necessary to analyze the appropriateness of trying to find where Brazilian law would apply to construing of trusts and the consequences arising therefrom. Brazilian law would necessarily apply to any core legal matters that may impact Brazilian public order or sovereignty (article 17 of Decree-law No. 4,657, dated September 4, 1942).[8] Public order is a non-clearly defined concept, but under Decree-law No. 4,657/42 any rules directed at the protection of Brazilian necessary heirs as well as core legal principles in each area of law (as the protection of donors) would be covered by this concept.

In summary, the considerations above lead to the following conclusions. Whereas trusts have no equivalent in Brazil, a trust created under non-Brazilian laws

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[4] Original wording: "*Art. 1.995. Se não se restituírem os bens sonegados, por já não os ter o sonegador em seu poder, pagará ele a importância dos valores que ocultou, mais as perdas e danos*".

[5] Original wording: "*Art. 549. Nula é também a doação quanto à parte que exceder à de que o doador, no momento da liberalidade, poderia dispor em testamento*".

[6] Original wording: "*Art. 1.846. Pertence aos herdeiros necessários, de pleno direito, a metade dos bens da herança, constituindo a legítima*".

[7] Original wording: "*Art. 548. É nula a doação de todos os bens sem reserva de parte, ou renda suficiente para a subsistência do doador*".

[8] Original wording: "*Art. 17. As leis, atos e sentenças de outro país, bem como quaisquer declarações de vontade, não terão eficácia no Brasil, quando ofenderem a soberania nacional, a ordem pública e os bons costumes*".

should notwithstanding be accepted by Brazilian courts. Also, Brazilian forced heirship rules as well as rules in Brazilian Civil Law directed at the protection of donors would be applied by Brazilian courts whatever the law chosen to govern the trust. Finally, such Brazilian rules of mandatory application would prevent donations to the detriment of issue, living ancestors or spouse, and prevent donations whenever their amount and extent would impair de means of livelihood of the donor.

Also, tax concerns – which are the main reason for most of the trusts settled – promptly arise. Beneficiaries shall only declare such assets to the local tax authorities when they acquire legal disposition on them, in other words, at the "vesting" moment. Donation tax should be levied upon the assets transferred to the trustee by the settlor and afterwards received by beneficiaries, but this is not applicable to new assets effectively earned by the trustee as a result of the management of the wealth held under trust. In such case, only income tax would be levied upon the assets received by the beneficiaries, and only over the portion which exceeds the amount originally transferred by the settlor.

Another advantage of using trust in Latin American jurisdictions is the possibility of appointing "protectors" to serve as a safeguard in favor of the beneficiaries. According to the Anglo-Saxon doctrine, "*at the very least, a trust protector must act solely for the benefit of the trust beneficiaries and cannot use his or her powers for personal benefit. In other words, a trust protector owes a duty of loyalty to trust beneficiaries that is similar to that owed by trustees*".[9] The appointment of a protector is more flexible than similar Civil Law institutes, such as the "*guardianship*" ("*tutela*"), which may be established with the death of minors' parents or when a judge remove the "family power" from parents.[10] Protectorship can be freely established by a settlor of a trust, and the powers of the protector are much more depending on the intention of the settlor than powers imposed by law for guardians or "*tutores*". Additionally, interests of the beneficiaries are safe due to the fiduciary duties of protectors, while such fiduciary relationship does not exist in similar cases in the Civil Law jurisdictions. The support by protectors is an important tool for succession plans, since one of the most difficulties of patriarchs is to find enforceable and effective legal mechanisms to ensure the implementation of the idealized management and transmission of wealth.

Brazilian Law also sets forth the "*fideicomisso*", which has similar features with a few aspects of trusts, but is not sufficiently equivalent to trusts (Article 1,915 of the

[9] Ausness, Richard C., When is a Trust Protector a Fiduciary? (March 20, 2015). Quinnipiac Probate Law Journal, Vol. 27, No. 3, 2014. Available at SSRN: https://ssrn.com/abstract=2599515

[10] Articles 1,728 of the Brazilian Civil Code.

Brazilian Civil Code).[11] Due to the use of its homonym in Spanish, its use is frequently misunderstood. In Brazil, a "*fideicomisso*" means only the power of the testator to appoint a "fiduciary" third party (natural person) to "receive" the inherited assets and manage them until his own death, in the benefit of the heir. Another possible confusion arising out from the coincidence of words to be clarified is that the "fiduciary" third party is not bound to the "fiduciary duties" generally applicable to trustees. At most, it is possible to assert that the "fiduciary" linked to a "*fideicomisso*" is bound by "moral" duties – just as a trustee is – naturally related to any fiduciary relationships. This concept is clearly explained by HARDING (2014): "*If it can be shown that moral duties grounded in respect arise in fiduciary relationships, then, because of the strong association between fiduciary relationships and trust, it may be asserted with confidence that there is a strong contingent connection between trust and those moral duties*".[12]

Not by chance, there has been attempts of the Brazilian National Congress to regulate trust in the Brazilian Law, enabling a treatment of trusts by Brazilian courts which would not depend on broad construing exercises and would provide Brazilian families with higher legal certainty with regards to their succession plans. This was the case of the Bill of Law No. 4,809, of 1998. Article 1 of such Bill of Law defined trusts (or the "fiduciary agreement") as follows: "By means of the fiduciary agreement, one of the parties, called the '*settlor'* (*'fiduciante'*), transfers the fiduciary property of assets or rights to another party, called the '*trustee*' (*'fiduciário*'), for such party to manage the assets in the benefit of a third party, called 'beneficiary', or of the '*settlor*' himself, and transfers the assets thereto or to other third parties, as established in the deed".[13] It must be noticed that – in line of the abovementioned "*numerus clusus*" principle, such Bill of Law had the deficiency of not creating a new *in rem* or property right (and therefore, not really being capable of introducing the trusteeship regime in Brazil).

A similar initiative was tried in France. In February 2007, the French Parliament introduced, under Chapter 14 of the Civil Code, the "*fiducie*", based on the commitments undertook pursuant to The Hague Convention of 1 July 1985 on the Law

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[11] Original wording: "*Art. 1.951. Pode o testador instituir herdeiros ou legatários, estabelecendo que, por ocasião de sua morte, a herança ou o legado se transmita ao fiduciário, resolvendo-se o direito deste, por sua morte, a certo tempo ou sob certa condição, em favor de outrem, que se qualifica de fideicomissário.*"

[12] Harding, Matthew, Trust and Fiduciary Law (June 17, 2014). Oxford Journal of Legal Studies, Vol 33. No. 1, 2013; U of Melbourne Legal Studies Research Paper No. 686.

[13] Original wording: "*Art. 1°. Pelo contrato de fidúcia uma das partes, denominada fiduciante, transmite a propriedade fiduciária de bens ou direitos a outra, denominada fiduciário, para que este os administre em proveito de um terceiro, denominado beneficiário, ou do próprio fiduciante, e os transmita a estes ou a terceiros, de acordo com o estipulado no contrato.*".

Applicable to Trusts and on their Recognition[14]. Despite the absence of real or *in rem* rights in the "*fiducie*", the protections granted to the beneficiary were still more effective than in a pure contractual arrangement.[15]

Obviously, the "fiduciary agreement" is not capable of encompassing all the complexity of trusts recognized by the Common Law and developed by centuries of case law. The admission of the divisibility of property is not easily accepted in Latin American countries, and it would impact other institutes. Therefore, Bill of Law No. 4,809/1998 has never been approved. Rather, there are more attempts of issuance of regulations concerning the taxation of distributions made by trustees to Brazilian citizens, since collection of taxes is a higher priority of the local government. However, no specific regulation for taxation of trusts has been enacted so far, and lawyers all over the country keep construing theories of what the correct taxation would be, based on the comparison of the taxation of other "similar" transaction – such as the donation.

Another barrier to be overcome for a broader use of trusts in Latin American jurisdictions is the prejudice suffered by trusts due to their recent use for criminal purposes, especially by politicians in money laundering schemes. The most famous case in Brazil was played by the former Speaker of the House Mr. Eduardo Cunha, who affirmed to a parliamentary inquiry committee that he had no foreign bank accounts.[16] After the discovery of accounts linked to Mr. Cunha and his wife, he argued that he was not the owner of the accounts, but "just their beneficiary". Despite the technical approach, Mr. Cunha's argument was evidently cynical,[17] and it did not take too long until the cancellation of his parliamentary mandate and, afterwards, his arrest.

In this sense, the function of trusts shall be correctly and patiently explained to Latin American families, as well as the means to ensure transparency and disclosure in strict compliance with local laws.

Other aspect to be explained – and implemented – is that the settlement of a trust is not different in its essential aspects from other kinds of "disposition" of assets, and must follow the rules applicable thereto. For example, as the case may be, the settlement must be preceded by the authorization from spouses (depending on the marital regime),

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[14] Available at <www.hcch.net/index_en.php?act=conventions.status&cid=59#nonmem>. Last accessed on May 26, 2018.

[15] KOESSLER, James. *Is there room for the trust in a civil law system? The French and Italian perspective.* March 2012. Available at < http://www.jameskoessler.com/wp-content/uploads/2012/08/Trust-in-Civil-Law.pdf>. Last accessed on May 26, 2018.

[16] Available at <http://www.bbc.com/portuguese/noticias/2015/11/151115_cunha_versoes_ms_ab>. Last accessed on May 23, 2018.

[17] A remarkable episode of the proceeding for cancellation of the parliamentary mandate of Eduardo Cunha was the questioning of the Congressman Julio Delgado, who asked Mr. Cunha if "the trust" was the one who drank the wines bought with the money held in foreign accounts. Available at < http://www1.folha.uol.com.br/poder/2016/05/1772919-quem-bebe-vinhos-de-us-1000-o-senhor-ou-o-trust-questiona-deputado-a-cunha.shtml>. Last accessed on May 23, 2018.

the forced heirship shares shall be respected, the settlor shall preserve in his ownership sufficient assets for his livelihood, and the rights of creditors of the settlor shall be observed (otherwise, the settlement of the trust would consist in a fraud). In this case, even the courts of the jurisdiction governing the trust would not enforce the rights of the beneficiaries under the trust (for instance, it is worth to mention the case "GRUPO TORRAS S.A. v. AL SABAH and SIX OTHERS", ruled by the Royal Court of Jersey).[18]

An important matter to be considered in LatAm jurisdictions also is the enforceability that local courts would provide the settlement with; especially if the trustee holds assets in the jurisdiction of the Settlor and beneficiaries. For example, in Brazil, according to the Brazilian Civil Procedure Code, Brazilian courts are able to judge matters in which: the defendant (or its subsidiaries, affiliates or branches) is domiciled in Brazil, the obligation should have been accomplished in Brazil, the matter or action discussed have occurred in Brazil. The same applies to lawsuits involving consumer relationship with Brazilian residents and when the parties agree to accept the Brazilian jurisdiction. On the other hand, matters involving Brazilian real estate properties and matters of heirship related to assets in Brazil must be exclusively ruled by Brazilian courts.[19] In this sense, it would be acceptable for local courts to rule matters involving trusts possible to trust far as local courts understand that a relationship between clients and banks is a "consumer relationship", and also when and if the assets held under trusts are located in Brazil.

Another aspect to be considered is the applicability of the The Hague Convention[20]. According to such convention (pursuant to its Article 6 which sets forth "*A trust shall be governed by the law chosen by the settlor. The choice must be express or be implied in the terms of the instrument creating or the writing evidencing the trust,*

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[18] Complete decision available at <https://star.worldbank.org/corruption-cases/sites/corruption-cases/files/documents/arw/KIO_Jersey_Esteem_Settlement_2002_JLR_53.pdf>. Last accessed on May 23, 2018.

[19] Original wording: "*Art. 21. Compete à autoridade judiciária brasileira processar e julgar as ações em que:*
I - o réu, qualquer que seja a sua nacionalidade, estiver domiciliado no Brasil;
II - no Brasil tiver de ser cumprida a obrigação;
III - o fundamento seja fato ocorrido ou ato praticado no Brasil.
Parágrafo único. Para o fim do disposto no inciso I, considera-se domiciliada no Brasil a pessoa jurídica estrangeira que nele tiver agência, filial ou sucursal"; and
"*Art. 23. Compete à autoridade judiciária brasileira, com exclusão de qualquer outra:*
I - conhecer de ações relativas a imóveis situados no Brasil;
II - em matéria de sucessão hereditária, proceder à confirmação de testamento particular e ao inventário e à partilha de bens situados no Brasil, ainda que o autor da herança seja de nacionalidade estrangeira ou tenha domicílio fora do território nacional;
III - em divórcio, separação judicial ou dissolução de união estável, proceder à partilha de bens situados no Brasil, ainda que o titular seja de nacionalidade estrangeira ou tenha domicílio fora do território nacional."

[20] Available at <www.hcch.net/index_en.php?act=conventions.status&cid=59#nonmem>. Last accessed on May 26, 2018.

interpreted, if necessary, in the light of the circumstances of the case"), trusts should be ruled preferably by the law chosen by the Settlor or, if no one is chosen, by the laws of the jurisdiction of the trustee, of the assets held under trust or of the place where the goals of the trusts should be performed.

In countries of the Civil Law system, it is also very important that the trust deed does not breach any "public order" rules. According to SALOMÃO NETO (2016), breaching such rules would prevent trusts that violate the rules of forced heirship from being recognized in Brazil. The concept of "public order" is indeed and intentionally open, but it undeniably encompasses the individual guarantees of natural persons, the constitutional dispositions about the economic order, as well as the basic principles of civil and criminal laws.[21]

This said, it is evident that the use of trust for wealth and succession planning purposes should be demystified and encouraged in Latin American jurisdictions. The challenges will be huge and will keep existing as long as ancient legal traditions remain in force – what gives to lawyers and advisors an even bigger field to act, educate and create.

[21] SALOMÃO NETO, Eduardo. *O Trust e o Direito Brasileiro*. São Paulo: Trevisan, 2016. Pages 107-108.