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Trusts vs Foundations: Issues of Forced Heirship in Different Jurisdictions

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"At all costs one must have wealth, control wealth, and protect wealth."

Oscar Wilde (1854-1900)

1. ABSTRACT

Forced heirship has plagued and hindered the intentions of men for years. These legal provisions, imposed rigorously in various jurisdictions around the world, have crippled not only intention but individuals' patrimonial distribution in the past centuries.

In considering whether forced heirship could be adeptly circumvented, it is necessary to study the purpose that such legal phenomenon is meant to achieve before considering whether it can and should be avoided. This paper will consider *origins and historic evolution of forced heirship, implementation of forced heirship in various jurisdictions, the traditional approach to solving the problem,* and an *alternative solution* to demonstrate that forced heirship can be legally bypassed.

2. FORCED HEIRSHIP

In this section we will discuss the *idea behind forced heirship, its history, its evolution through various jurisdictions, the infamous clawback provision,* and *its impact on today's world.*

2.1 Forced Heirship

The concept of *forced heirship* refers to the set of legal provisions[1] found in testamentary laws which limit an individual's freedom of testation by fragmenting that person's estate[2] and stipulating how that person may dispose of his or her assets after his or her death. The deceased's heirs have a right to claim a portion, depending on their system's dictum, of that partible inheritance[3]. Forced heirship divides a deceased's estate into non-disposable assets, claimable by heirs, and disposable assets. These *forced heirs*[4] are persons, usually children and spouse, whom the testator or donor cannot exclude from the inheritance due to the fixed share provisions which set aside a specific quota of the property to satisfy the established percentage entitled to them.

However, this legal bear trap does not quench itself just like that. It sprouts its entrapping roots on a person's death bed, to later on slither into his or her *inter vivos* actions.

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[1] For examples of forced heirship provisions see the legislations of: Argentina, Kuwait, Mexico, Brazil, France, Japan, Spain, Italy, Jersey, Louisiana, Saudi Arabia, and Scotland.

[2] For a discussion on the concept of "estate", its differences from the Civilian "patrimony" concept, and a specific study on the civil and common law jurisdictions' notion of property, see Paul Matthew's *From Obligation to Property, and Back Again? The Future of the Non-Charitable Purpose Trust.* p. 213-216.

[3] *Partible inheritance* refers to a system of inheritance in which a deceased person's estate is divided equally among the heirs (Merriam-Webster Dictionary).

[4] *Forced Heirship - Trusts and Other Problems*. p. 174

Forced heirship, seen as a *Death Star*[5] by all estate planners, can ensure compliance to its rules and assure appropriate fixed distribution of a deceased's estate amongst its heirs by restricting *inter vivos* transfers of property, which could have in one way or another, diminished the portion entitled to such forced heirs[6]. But where did this abominable imposition originate? How did it spread through every continent in the world like a ravaging epidemic?

2.2 History

To those reading this paper, the term forced heirship might sound unfamiliar. But perhaps the terms *sucesión forzosa, légitime, réserve héréditaire, legítima, le succesioni,* or *pflichtteilsrech* ring a bell. These are all expressions, in various languages, associated with the concept of forced heirship.

In order to map out the origins of forced heirship it was necessary to spend infinite amounts of time pinpointing the different epicenters which might have contributed to the overall idea which we see today. In doing so, we came to the conclusion that modern forced heirship derives from a combination of Roman, Aztec, Islam, and Jewish systems of inheritance, which we will now discuss.

2.2.1 Roman Law

Roman influence can be seen in every corner of the globe, from islands to entire continents. Rome sparked the flame which ignited areas such as: science, mathematics, astrology, and law. The climax of Roman legal effervescence was the *Corpus Iuris Civilis*, or Body of Civil Law, which gave birth to codified law, to Civil Law. During the times of the Roman Empire, their was no codified set of rules establishing a forced heirship regime, however, their were *Justinian*[7] dispositions regarding the ability of children who had been disinherited in a will by the heads of families without any good reason to complain against the authorities that they had been cut out or passed over[8]. This so-called undutiful will is truly the origin and birth of the concept that we now called forced heirship. The existence of a *patre familias* requirement imposed on all heads of families, further strengthened the idea of 'family above property'[9] which is the predominant explanation for the existence of forced heirship even in today's ever-changing world.

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[5] Making reference to the pedagogic word battle engaged between two eminences of the Trust World, Paul Matthews and Antony Duckworth, in 1997.
[6] *The Forced Heirship Issue and Jersey Trust Law*. p. 23
[7] Refers to the *Codex Justinianus*, formally *Corpus Iuris Civilis*, or Body of Civil Code.
[8] As seen in Alan Watson's translataion of *The Digest of Justinian: Volume 1.*
[9] Making reference to Professor Rosalind F. Croucher's brilliant article on freedom of testation, *To do 'As he lists' - the leitmotif of liberty in succession law.*

Centuries later, this playground of gladiators and philosophers conceived countries like France, Italy, Spain, and Portugal. These Roman offspring, impregnated with such civilian mentalities, ventured off to conquer Latin America, the Caribbean, and Africa, and left the Roman seed planted in every colony they established.

2.2.2 Aztec Law

The Aztecs are the ancestors of the the people that now inhabit the region stretching from northern Mexico to the lower regions of Guatemala. Although the laws that now govern Mexico have varied drastically in comparison with those laid down by ancient legislations, there are areas of Mexico inhabited by indigenous groups that hold some of the customs and laws of their ancestors who once populated these lands.

Succession law during the Pre-Hispanic era could be practiced by all men, rich or poor, in regards to their particular properties, such as: movable goods, immovable goods, and slaves[10]. Their were two types of succession: voluntary and legitimate. In the legitimate, the male sons were the only ones to enjoy the property of their deceased parent.

Post-Colonization injected Latin America with Roman-Occidental heritage product of the Spanish conquering institutions which integrated Roman ideals into those territories which they conquered. However, such Roman ideals had come to us mixed with Islamic influence, due to the fact that as mentioned earlier, after the Crusades, Muslim culture fused with European. When Spain and Portugal conquered most of the American land mass, the New Continent, rich in pseudo-Aztec essence absorbed Roman-Islamic principles, concepts, and cultural components.

2.2.3 Islamic Law

Islamic inheritance law, or Shari'ah inheritance law, derives its foundations from the Holy Quran, the customs laid down by the Prophet, and furthermore, by the educational studies based on the Quran and such customs[11]. Rumsey glorified Islamic law by stating that its inheritance laws formed the most efficient and polished methodology for the redistribution of property known to the modern world[12].

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[10] For a discussion on the history of succession in Mexico, see Batista, Miguel. *Sucesión : La Historia en Látino América*. 135-190.

[11] This paper does not attempt to conduct a study of the world's legal systems, but to extract necessary fragments of their legislations referring to forced heirship. For a detailed analysis of Islamic law, its origins, and Shari'ah provisions, can be found in Zweigert & Kötz. *An Introduction to Comparative Law: The Legal Families of the World.* 303-312.

[12] Professor Almaric Rumsey (1825-1899) taught at King's College, University of London.

Shari'ah law states that upon a person's death, their property must satisfy the following four principles:

1. Pay his/her funeral and burial expenses.
2. Pay his/her debts.
3. Execute his will/bequest (maximum 1/3 of his/her property).
4. Distribute the remainder of his/her estate/property according to Shari'ah Law.[13]

Those four standards are the backbone of the inheritance system in Muslim countries. Furthermore, passages within the Quran such as: "Allah commands you regarding your children. For the male a share equivalent to that of two females" and "If there are women (daughters) more than two, then for them two thirds of the inheritance; and if there is only one then it is half"[14]. These extracts further strengthened the fixed shares entitled to the respective heirs.

These statutes favored the male heirs and crippled female heirs' chances of obtaining a significant fragment of the inheritance, but when the European continent engaged in the Crusades, and the concept of forced heirship, along with the concept of the *trust*, were imported back home, these gender-oppressing provisions were modified or suppressed.

2.2.4 Jewish Law

The final contributor to the forced heirship dispositions that plague the estates of men across the globe, is Jewish Law. Vague Biblical references encouraged the establishment of inheritance laws within Israel to ensure the stability of its tribes.

Such Biblical extracts such as *'if a man die, and have no son, then ye shall cause his inheritance to pass unto his daughter"* not only fortified the fixed share property quotas that would pass on to the forced heirs, but it also strengthened the male heirs[15]. Furthermore, just as with Islamic Law, gender-favoring dispositions were abolished as they were integrated into other continental legal systems.

Jewish presence within every continent grew exponentially after the Second World War due to an exodus from Western European countries as a direct result of the incessant chase that the Reich gave to non-Aryan races. Argentina, Mexico, Brazil, the Caribbean, and places in Central America

[13] *Islamic Inheritance,* Wikipedia.
[14] Quran 4:11
[15] For a detailed article on Jewish Law and its impact on modern world occurrences see Verdonck's book *Jewish communities, laws, and customs in recent years.* p. 233.

suddenly had growing Jewish communities within their societies. The integration of this culture, with its ideals, into such countries, put the cherry on the cake, producing a structured, predestined, and fixed inheritance system.

2.3 The evolution of Forced Heirship in various jurisdictions

With such an intrinsic *mélange*[16] of cultures, ideas, and systems, forced heirship cemented itself as an institution in various legal frameworks. Stretching all over Latin America, continental Europe, the Middle East, parts of Africa, Asia, and even placing a seed in remote Anglo-Saxon jurisdictions. Due to such a prolific diffusion countries such as Scotland, South Africa, China, Japan, Canada (Quebec), and the United States (Louisiana), among others, derived their set of laws from the most widely practiced system of law in the planet, civil law. Partly due to the potent integration of the Napoleonic Code and the BGB (German Code), both based on Roman law, into all those law spheres. Additionally, the globalization of Muslim and Jewish religions further aided in establishing a fixed share scheme for the administration and distribution of property, *post mortem*.

These are a few of the resulting regulatory succession infrastructures that are governed by some form of forced heirship:

In Brazil heirs and the surviving spouse are entitled to 50% of the deceased's estate. If their were no children in the marriage, then parents or grandparents would also be able to claim a share of the estate[17].

In France, the country with the strictest and most powerful forced heirship provisions, depending on the number of heirs *la reserve*[18] could range from 50% to 75% of the estate. The surviving spouse is not a forced heir.

In Louisiana, a state with codified law and influenced by the Napoleonic Code, the forced share may be claimed by forced heirs that are 24 years of age or younger. The fixed share is at least 50% of the estate of the deceased[19].

In Philippines, the Civil Code regulates the compulsory share that compulsory heirs of the deceased are entitled to. The situation between legitimate and illegitimate children is the same. Disregarding the legitimacy of the child, he or she is entitled to 50% of the estate[20].

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[16] French expression meaning "mix", but used in past centuries to describe the constantly evolving socio-ethnic ambient in the conquered lands due to the constant exposure to new cultures.

[17] *Legitime*, Wikipedia.

[18] Referring to the fixed share established by the law.

[19] For a detailed analysis on the forced heirship provisions that have evolved continuously in the state of Louisiana, see Melchers, James. *Probate, Ownership of Property, Forced Heirship*.

[20] For a complete article on the inheritance systems of various Asian countries see Graeme Brigg's *Trusts for Succession and Estate Planning for ASIAN Investors.* p.18-25.

Four jurisdictions from the corners of the world presenting evidence of the modern day concept of forced heirship. While some legislations establish a larger compulsory share for the forced heirs, others exclude surviving spouses from the overall fixed share claim.

Furthermore, what started out in the Roman Empire era, evolved into a creature of its own. Past centuries feared the destruction of dynasties, wealth, and family estates upon the demise of their fathers. New millennia have forged and armed such a concept with weapons that allow it to not only grasp and tear apart the most intricate structures upon a person's death, but also to attack actions performed while that person was still living.

2.4 The infamous Claw Back[21]

Many theorists have attempted to intercept and circumvent these legal impositions while the individual in question is *alive.* It is an understood notion that forced heirship is triggered *post mortem*, but what prevents a testator or donor from alienating his property through *inter vivos* gifts? And the answer is simple. Whoever attempts to bypass, deceive, or avoid such predetermined fixed share allotments will encounter the unparalleled wrath of forced heirship's *Leviathan*[22]: the claw back[23].

The clawback mechanism is integrated wherever a type of *reserve* provision exists. It works as follows: if the *quotité disponible*[24] of an estate, taking into consideration testamentary and *inter vivos* gifts, surpasses the established compulsory share, then forced heirs can claim such testamentary gifts and clawback any gifts that the deceased made during his or her lifetime. The clawback process occurs in an inverse chronological sequence, meaning that the testamentary gifts are attacked prior to those made while the testator or donor was alive[25].

The full deployment of such *Leviathan* can be seen clearly in one particular case. *Vogelius v Vogelius*[26] is an unknown legal proceeding that exemplifies the utilization of clawback provisions to the full extent to attack *inter vivos* transactions. The case involved a claim by the forced heirs of the deceased, an Argentine citizen, against other forced heirs, children from another marriage, with

[21] For an incredible analysis and commentary on the issue of clawback, read Paisley's *A Comparative Analysis of Succession Laws of Member States of the European Union on the Issue of Clawback.*
[22] Referring to *The Bible's* Leviathan.
[23] For an in depth analysis of the clawback provision, principally in France read Duckworth's article, *An offshore view of forced heirship - global conflict and its planning implications: Part 1*.
[24] Referring to the disposable portion of an estate.
[25] For a thorough explanation of the clawback mechanism and its effects, specially in jurisdictions with strong forced heirship like France, see any of the *In Focus: Succession and Forced Heirship* in Trust and Trustees, specifically the *Onshore: France* article written by Jean-Marc Tirard.
[26] [2006] 81TELR 619. Another case contemplating *rapport á la masse* (clawback) was *Amy v Amy.* [1968] JJ 981

regards to a portion of the estate that had been settled in an English trust with them as beneficiaries while the person was still alive. The judge held that the *inter vivos* gifts were subject to clawback and as such would form part of the *réserve héréditaire* to be distributed equally amongst all the forced heirs.

In essence, the clawback advocators claim that the *quotité disponible* available to the forced heirs should be, as stated by Delnoy, "that of a mass of goods which must have corresponded as closely as possible to that which would have fallen within the patrimony of the deceased at his death if he had never made any gratuitous disposals"[27].

3. THE TRADITIONAL APPROACH

The clawback might be able to attack *inter vivos* gifts made by the testator or donor, but what prevents him or her from cloaking such gifts to deceive the law? Trusts have been around for more than 800 years, and since the Middle Ages, trusts have served the Anglo-Saxons with a shield against incoming threats, whether it was the taxes owed to the *feudal lord*[28] or inheritance taxes owed to the Crown[29].

But how could these Medievally dated structures provide clients a solution to such *Gordian*[30] provisions? Part of this paper's focus is the employment of trusts in order to avoid forced heirship. Therefore, we will avoid going into depth on the trust institution itself and instead, we will discuss various components associated with forced heirship in different jurisdictions, such as *settlor control, protectors and letters of wishes, beneficiaries' right to information, potential challenges,* and we will make reference to *successful and unsuccessful avoidance of forced heirship.*

3.1 Trusts[31]

A trust consists, in its most basic levels, of a legal relationship between a settlor and a trustee whereby the settlor alienates his or her assets by transferring them to that trustee who holds and manages such assets for the benefit of the beneficiaries[32].

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[27] Paul Delnoy, *Les Libéralités et les Successions.* p. 237.
[28] Vassals and peasants living within the walls of the feudal lord's property had the obligation to pay the feudal lord with crops, military service, and taxes.
[29] Inheritance tax is governed by section 158 and 159 of the Inheritance Tax Act 1984.
[30] Referring to the legend of Gordius, king of Gordium, who tied an intricate knot and prophesied that whoever untied it would become the ruler of Asia. It was cut through with a sword by Alexander the Great.
[31] For an in depth and up to date text on trusts see Parker and Mellows' *The Modern Law of Trusts.*
[32] Hayton and Mitchell's *The Law of Trusts and Equitable Remedies* p. 68.

The assets transferred form part of a trust fund and the trustee or trustees, the position could be held by an individual or a company, administer such assets in accordance to the terms set out in the trust deed. While trusts can take on many shapes, discretionary trusts are the most popular because they allow trustees to adapt and react quickly to any arising situation, therefore providing the settlor a flexible structure tailored to his very needs.

As such, the use of trusts has increased exponentially due to a surge of personal wealth around the globe. However, the world's governments, organizations, and institutions have gone on a Robin Hood Crusade[33] against the trust in order to justify their own restructuring programs after the world's economic crisis. Moneyed individuals wishing to engage in estate planning, specially when attempting to circumvent forced heirship provisions existent in their countries, might wish to reconsider the use of trusts. We will discuss the dangers, pitfalls, and attacks that trusts have encountered in the past.

3.1.1 Settlor Control

Relinquishing your wealth or property voluntarily can come across as an insane idea. And in fact, this is one of the main setbacks when contemplating the idea of settling property on trust. For a trust to function and to be recognized as such as the same time, there must be a transfer of property from the settlor to the trustee[34].

A settlor wishing to avoid inheritance taxes and forced heirship provisions, as seen in the *Esteem Settlement*[35] case, would not be content with handing over control of their wealth to a trustee and would therefore wish to have power over the trustee's actions. It would be possible for the settlor to reserve some degree of administrative power. But there is a limit[36]. Ignoring this limit would lead the trust to be considered a sham, which we will discuss later.

The Hague Trusts Convention of 1985 contains a clear set of guidelines in its Article 2 with regards to the requirements that a trust must comply with in order for it to be considered legitimate. If such requirements are not met or are violated, the trust would cease to uphold its true nature. There are

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[33] Referring to the legend of Robin Hood who stole from the rich and gave to the poor. In this case, the "Evil Empire", as stated by Goldsworth, has gone after the wealthy who hide their money in order to use the proceeds as a type of tax to pay for their economic recovery.

[34] *Lewin on Trusts* p. 47.

[35] *Abacus Ltd. & Grupo Torras SA v Sheikh Fahad Mohammed Al-Sabah* [2002] JLR 53 [hereinafter *Esteem*]. Settlor successfully avoided Kuwaiti forced heirship rules, while still retaining control over the assets on trust. However, the court 'pierced the veil' of the structure in order to find the true beneficial interests behind the trusts.

[36] As stated by Donovan Waters in his article *Settlor control - what kind of a problem is it?*

jurisdictions which have twisted their legislations[37] in order to grant settlors with an almost complete control over the trustees, over the assets in trust, and specially, over the actions that beneficiaries can take against the previous two. However, other legislations might not approve this reservation of powers by the settlor.

3.1.2 Protectors and Letters of Wishes

Since such a detachment proves to be so difficult and so incomprehensible to the settlor, the idea of a *protector* might ease his mind into engaging in such an intricate legal relationship. The role of the protector can be fulfilled by a close friend, a trustworthy person, or a qualified individual. In essence, the protector is the top layer of control and protection of the settlor's interests, the beneficiaries' interest, and the trust fund itself. It hovers above the trustees like an eagle and acts when necessary.

The protector's powers originate from the terms agreed on the trust instrument[38]. And although it has never been documented, a protector's powers and duties are analogous to those of trustees[39] and therefore owe the beneficiaries the same fiduciary role[40]. Therefore, the appointment of a protector can provide the settlor with a supervising mechanism for trustee activity, specially when the settlor's position is threatened. In a landmark *van Knierem*[41] case, regarding protectors, the settlor and the other directors had a dispute over the re-election of the settlor to the Board of Directors of a company. The trustee needed to vote in favor of the settlor, and to ensure this, the protector, who was a close friend of the settlor, removed the trustees and appointed new ones. Everyone questioned whether the protector was looking after his close friend or the beneficiaries. The court condoned the actions of the protector, but stated that the protector's powers were fiduciary[42].

The protector might give the settlor control over the trustees and therefore control over their actions with respect to the trust fund, but the ever-evolving legal world has taken note of this and have started to think the way Henderson J considered the concept of the protector[43] in a recent case. So

[37] Cayman Islands Trusts Law 2001 s 14 and Bahamas Trustee Act 1998 s 81(1) are excellent examples.
[38] Peter Hodson's *The trust protector: friend or foe?* p. 9.
[39] *Mourant & Co Trustees v Magnus and Others*. [2004] JRC
[40] As Millet LJ stated in *Armitage v Nurse.* [1997] 2 ALL ER 705 [hereinafter *Armitage*], "the duties of the trustees to perform the trust honestly and in good faith is the minimum necessary to give substance to the trusts."
[41] *Jurgen van Knierem v Bermuda Trust Company Ltd. and Grosvenor Trust Company Ltd.* [1994] Supreme Court of Bermuda 1 BOCM 116.
[42] For a detailed article on protectors see Stuart Pryke's *Of protectors and enforcers.* p. 64-72.
[43] In *HSBC International Trustee Limited v Wong Kit Wan*. [2006] CILR 323, he said that "the appointment of a protector is intended to provide an additional layer of control over the trust...the protector is another obstacle for authorities".

protectors are no longer seen as a shield but more like an internal threat to the trust, giving courts the advantage when assessing the validity of the trust.

Another common tool which also goes side by side with the protector institution is the use of letters of wishes or memoranda of wishes[44] to instruct the trustee how to act. But while these have aided trustees in the execution of their discretionary powers, they have also been used to hide instruction-sets from the settlor to the trustee, and therefore achieve a degree of diplomatic puppeteering. These letters or memoranda are not secret[45], as the settlor might want them to be, and can give beneficiaries a solid platform to set aside a trust for being a sham.

Settlor control is an ungraspable idea in the world of the trust because, whether it is attempted directly or through a third party, the court and the beneficiaries will see through the parties' intention and will attack it relentlessly.

3.1.3 Beneficiary's Right to Information

At the heart of the trust lies an irreducible core of obligations, as stated by Millet LJ in *Armitage*. However, it was *Londonderry*[46] and then *Schmidt*[47] that established the types of information that beneficiaries had access to. But if a trust is created by a settlor to have his or her estate managed, invested, and distributed by a trustee so that his or her children and spouse, who will probably be amongst the beneficiaries, are unaware of the existence of such structure, its functions, and its purpose, then what is the point of all this if those beneficiaries have a right to every piece of information. This particular right, engraved in the trust fund and the trust deed, is the gravitational pull that keeps such a structure together because without it, the trust would not have the indispensable irreducible core laid down in *Armitage* by judge Millet LJ.

Accounts, letters of wishes[48], emails, and phone call recordings all fall under the information that a trustee must release to the beneficiaries. Therefore, this completely disables the confidential purpose of having property settled on trust. Having these documents in possession, beneficiaries could use such information to invalidate the trust, persecute the assets, and even bring legal

[44] See *Hartigan Nominees Pty Ltd vs Rydge.* [1992] 29NSWLR 405 (letters of wishes are trust documents), *West v Lazard Brothers.* [1988] JLR 414 at 420 (accounts include all types of financial, accounting, etc., type of document), and *Bhander v Barclays Private Bank & Trust Co. Ltd.* [1998] 1 OFLR 497 (voluntary relinquishing of letters of wishes).
[45] This was proven in the famous case *Breakspear v Ackland.* [2008] EWHC 220 (Ch).
[46] *Re Londonderry's Settlement, Peat v Walsh.* [1964] 3 All ER 855.
[47] *Schmidt v Rosewood Trust Ltd.* [2003] UKPC 26.
[48] *Re Rabiotti's Settlement.* [2000] WTLR 953.

proceedings against the trustees[49]. Not only that, but trustees also have the duty to notify beneficiaries of their interests under a trust[50]. For a man who wishes for the distribution of his estate to remain private and confidential to the eyes of anyone but the trustee, this right, embedded in every trust instrument would be unacceptable[51]. The existence of such limitations provides another clear reason why the use of a trust would lag and possibly destroy any attempt to defeat forced heirship rules in a given jurisdiction. Their was one case however, where an improved perspective was exhibited. In *Re Tillot*[52] the judge held that a beneficiary who was entitled to a share of a portion of a trust, had rights with regards to the access to information information with regards to his or her portion, and not to the part of the estate to which he or she did not hold interest in. Such a decision, if implemented in future jurisprudence, would have made the use of offshore centers, with legislations favoring the elimination of rights to information by beneficiaries, completely unnecessary.

Furthermore, there are cases that strengthen the position of offshore centers as prime locations for trusts due to the need to comply with that jurisdictions' particular legislation. In *Re H*[53] trustees of a Cayman Island trust were asked to disclose information regarding the assets held in the trust fund. However, as Smillie J stated, the trustees owe a fiduciary obligation to the entire class of beneficiaries, and if this divulgence of certain pieces of information could jeopardize the position of that class, then the trustee must abstain from such exposure. But disregarding that very specific situation, landmark cases, like Schmidt, established that beneficiaries have a right to any type of information concerning the trust, with very few exceptions such as documents relating to the management of the trust and the transactional business of that trust. So under which category would documents evidencing the intentions of a settlor to circumvent provisions within particular legislations fall under? Or more importantly, would beneficiaries, who also happen to be the forced heirs of the settlor, be able to compel trustees to relinquish information or documents that prove the settlor's intention to distribute his estate in a way differently than the one portrayed in the law? These are questions that strike at the heart of the trust institution and allow courts to juggle cases as they see fit, usually using particular cases to set examples amongst the international estate planning community and the wealthy individuals that seek to build pyramids with their estates buried next to them ready for distribution in the afterlife.

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[49] See Richard Morris' *Trustee's Liabilities Explored.* p. 6-10.
[50] As seen in *Hawksley v Maye.* [1965] 1 QB 24 and later on established in *Re Murphy's Settlement.* [1999] 1 WLR 282.
[51] Seen in *Lemos v Coutts and Co.* [1993] CILR 460 [hereinafter Lemos] where the trust was conceived to keep the allocation of the deceased's estate as secret as possible, specially from the heirs, who were also the beneficiaries.
[52] [1892] 1 Ch. 86.
[53] [1996] CILR 237

3.2 Potential Challenges

A trust designed and conceived to bypass forced heirship seeks to establish a number of certainties: settlor having control over the assets in the trust fund, settlor having direct influence over the trustee handling the trust fund through a protector or letters of wishes, and finally, settlor restricting the information that the heirs or beneficiaries have access to. Having established that none of these are certainties that a settlor can rely on due to the fact that they are attackable and past cases are living proof of that, what other potential challenges could a trust of this nature be exposed to?

3.2.1 Shams

Fortunes are made over the years, but are lost in a few days. So why not use a trust to ensure that a family fortune lasts for many generations? And that is usually the path taken by many wealthy men. They settle property on trust but since that property is their hard-earned money, giving up control of it, to a trustee, seems unthinkable. Beneficiaries, forced heirs, or authorities which suspect such a situation, could approach a court to have the trust set aside on the grounds of it being a *sham*[54].

A trust is created, as stated previously, by a complete transfer of property between settlor and trustee; and unless such a trust explicitly grants certain powers to the settlor, then the trustee's discretion must be completely uncorrupted when employed on behalf of the trust fund. Any type of conflict with this requirements would give others a stable ground for attack.

Snook[55] and *Rahman*[56] are the leading cases on the sham subject due to the spotlight that they both had at a certain moment and still have today. A sham has several modalities but it usually takes a common intention by the settlor and the trustee. *Snook* was a very old case that has been built upon in the past decades, since it laid down the principle components necessary for a sham to exist. Furthermore, *Rahman* displayed the typical indications of a sham due to the fact that the settlor treated the property in the trust fund as his own and the trustee condoned this activity even following the settlor's exact instructions.

A trust created between a settlor and a trustee, specially if the trustee has no understanding of his or her duties and simply follows the settlor's wishes[57], with the purpose of the settlor retaining control,

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[54] Lord Diplock said it best when he concluded that a sham "means acts done or documents executed by the parties to the sham which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations which the parties intend to create".

[55] *Snook v London & West Riding Investments Ltd.* [1967] 2 QB 786

[56] *Rahman v Chase Bank Trust Co.* [1991] JLR 103.

[57] *Turner v Turner.* [1983] 2 All ER 745.

interest, or title to the trust property would inevitably be categorized as a sham. The mere intention by one of the involved parties would give the court sufficient grounds to attack the trust. Very few trusts have survived such a challenge, Sheikh Fahad Al Sabah was one of the them[58].

3.2.2 Creditor Avoidance[59]

Asset protection trusts (APT) have been popular since the 1990s, but how effective are they? Cases such as *Hess v Line Trust Corp*[60], *Re Lawrence*[61], and one of the the first recorded APT cases, *Re Butterworth*[62], have proven that whether it's a discontent wife or a dangerous business endeavor, APTs could provide a solution.

However, APTs pose an enormous risk. Courts can easily challenge and attack APTs for the mere fact that they are usually set up in questionable offshore jurisdictions, such as the Cook Islands[63]. Not only that, but onshore cases like *Re Dawkins*[64] have proven that even in the mainland, avoiding creditors through settlements can prove to be difficult.

The *Hess* case is a perfect example of a successful APT, but in this case, it was the settlor's wife going after the assets. If it had been a major law firm, corporation, bank, or similar institution, with more resources, the case would have had another outcome.

3.2.3 Forced Heirship

Forced heirs challenging a trust for being a sham are a dime a dozen. Successful avoidance of forced heirship is in another league of its own. With the existence of such provisions in every continent and with clawback mechanisms ready to be deployed, few have ventured into such uncharted territories, and just a handful managed to come out unscathed.

The Grupo Torras[65] case set the mark when it efficiently bypassed forced heirship rules in Kuwait. The Esteem Settlement, which was the name of the trust, was conceived by the Sheikh with the sole purpose of avoiding Kuwaiti laws on forced inheritance, and while the court attempted to have the trust set aside for being a sham, they failed to pay attention to the true intention behind the

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[58] *Esteem.*
[59] For a detailed discussion on asset protection trusts and creditor avoidance schemes see Stewart Sterk's *Asset Protection Trusts: Trust Law's Race to the Bottom?*
[60] *Hess v Line Trust Corp.* [1998] Civ. App. No.17 International Tr. & Est. L. Rep. 249.
[61] *Goldberg v Lawrence*. [1998] 227 BR 907.
[62] *Re Butterworth*. [1881] LR 19 Ch. D. 588.
[63] The Cook Islands established an APT legislation in 1989 after seeing a potential for asset protection services, and established itself as a leader in financial services. Court decisions like the *Orange Grove* cases and in the *Anderson* decision tainted APTs.
[64] [1986] 2 FLR 360.
[65] ibid.

structure. Furthermore, legislation governing the trust instrument contained provisions protecting settlements from being invalidated by forced heirship claims.

Another case that received attention was *Casani v Mattei*[66], in which a settlement in the form of a will was attacked by the deceased's statutory heirs. The court reduced the property subject to the testamentary trust in favor of the statutory heirs. Once again, the focus was not on forced heirship but instead on the recognition of a trust in a Civil Law country[67]. The trust was a cloaked will which failed to bypass forced heirship provisions.

Sanchez v Sanchez de Davila[68] is the Everest in forced heirship avoidance. The case involved a wealthy father, Venezuelan, who conceived a trust in Miami with two of his children as beneficiaries. However, he had twelve other children in Venezuela, and when he died, the remaining heirs launched a forced heirship claim against the trust fund claiming that the funds should be returned to the executor so that he could distribute the estate equally amongst the heirs. The court ordered for the funds to be returned on the basis that the deceased lacked capacity to create a valid trust with assets subject to forced heirship allotment in Venezuela. The decision was appealed, and the court reversed its decision stating that the trust was governed by Florida law, and was therefore valid.

The *Lemos* case[69] must be mentioned because it proved what the authorities and the parties are willing to do to keep things under the radar. The sons of a deceased settlor sought to invalidate *inter vivos* transfers made by their father into a Cayman trust on the grounds that a violation of Greek forced heirship rules was taking place. Surprisingly, these disgruntled statutory heirs were also members of a class of discretionary beneficiaries to the trust, of which the spouse and daughters were also part of. Shortly after, one of the sons attempted to bring a separate action in Cayman against the trustees and asked for their removal. Unfortunately, the case was settled outside of the courtroom, but it gave us a glimpse of how effective anti-forced heirship provisions could be in offshore jurisdictions.

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[66] [1997] 1 ITELR 925. For a great analysis of the case and its recognition in Italian courts see Maurizio Lupoi's article *The Domestic Trust Theory Upheld in Italy.*

[67] Italy was the first Civil Law country to ratify the The Hague Convention on the Law Applicable to Trusts.

[68] [1989]547 SO 2D 943.

[69] For an in depth analysis of this case see McWeeney's seminar on *The Effectiveness of Statutory Provisions Outlawing Forced Heirship Claims.*

Having briefly discussed four different situations[70], an overlooked success, a failed attempt, an efficient avoidance, and an unreported bypass, we can ask the question: can trusts avoid forced heirship provisions effectively? The answer is: no. We can count with one hand the number of trusts that have survived. So is there a real panacea to this anomaly?

4. THE ALTERNATIVE SOLUTION

History has proved that private wealth was and will continue to be in peril and therefore it needs protection. Trusts, the modus operandi of choice, have been around for centuries and have been unable to provide an unfaltering defense. Trusts have a long history and an established body of jurisprudence, which explains why a vast portion of this paper was dedicated to it. Ironically, there is a structure which has been around for less than a century, and due to its constantly evolving nature, could in fact be the alternative and final solution to such an ongoing problem. We will discuss the *concept of the private interest foundation,* and the revolutionary structure of *the Panamanian Private Interest Foundation's (PIF)* as means to avoid forced heirship.

4.1 Foundations

Private interest foundations were conceived in Liechtenstein in 1926 as a preventive measure to protect family assets during times of financial instability, and to compete with the long-standing Anglo-Saxon trust. And since privacy supports personal freedom, the private interest foundation became the private wealth protection of a few smart wealthy men. In essence, a private interest foundation is dressed like a corporation, yet has the soul of a trust[71].

4.2 Panamanian Private Interest Foundation[72]

In 1995, inspired by the Liechtenstein PIF, Panama enacted a special law which created private interest foundations. Like a trust, a foundation is created by a transfer of assets to a person for the benefit of a class of beneficiaries. The main difference between both is that a foundation is an independent legal person, and may, therefore, own the assets transferred to it. These assets are managed by a foundation council in favor of the beneficiaries.

PIFs have numerous attractive features that make it a more adaptable, versatile, and flexible structure in comparison to their Anglo-Saxon elders. The main ones are:

- Duration: no perpetuity limitations.

[70] For other cases read Geoffrey Cone's article *Common law trusts by persons based in civil law jurisdictions: does New Zealand offer a solution?*, specifically the section on Forced Heirship.
[71] Expressed by a British solicitor in 1996.
[72] We will not go in depth into the concept of the foundation, only briefly. Instead, we will focus on the most attractive feature of the Panamanian PIF: its ability to avoid forced heirship, legally.

- Confidentiality: all the parties in the foundation can remain anonymous while the employees are subject to strict confidentiality rules punishable with monetary fines and incarceration.
- Charitable or for a profitable purpose: a general class of beneficiaries may be appointed, as well as unborn beneficiaries.
- Separate patrimony: the assets belong to the foundation, not to the founder.
- Low taxation: Panama has a territorial tax system, meaning that only income produced within the country pays tax.
- Minimum reporting requirements: foundations that do not pay taxes do not need to file tax returns or financial statements.
- Contractual freedom: founders can include any clauses or distribution plans with regards to the assets held; this includes post-mortem distributions, even if forced heirship provisions prevent it.

However, the most attractive component of the Panamanian PIF, is contained in article 14 of the Foundations Law[73] and it states that the existence of legal provisions in the country of domicile of the founder or the beneficiaries, related to inheritance matters, will not affect the validity of the Foundation, the distribution of the estate to the Foundation, nor the compliance or carrying on of its objectives[74].

To go back to the potential challenges that a trust may face, if a PIF endured the same attacks, the results would be nothing short of perfection. There is no such thing as excessive control by the founder and therefore, having the foundation deemed a sham because there are no sham foundations, and even it there was such a concept, the fact that the foundation has a legal personality, the court would never consider the idea of it being a sham. A founder may appoint, and is encouraged to appoint, a protector which oversees the activities carried out by the foundation council. A founder may also reserve a number of powers in the management and distribution of the foundation. With regards to creditor avoidance; creditors have three years to attack the foundation with substantial proofs in order to be recognized by a court. Beneficiaries' rights to information can be restricted in the foundation charter and through the employment of the protector.

Panamanian courts have denied requests by the Leicestershire Police of the UK for bank and corporate documents for a fraud case, they have denied a request by the Russian Federation Attorney General in a maritime fraud case deposing a Panama attorney, a request for documents relating to an account held in a Panama branch of a Spanish bank by a Zurich cantonal prosecutor

[73] Panama Foundation Law, No. 25, 12 June 1995.
[74] Alvaro Aguilar Alfu's *Panama:when Panama private foundations go to court - a case law review.*

and a questionnaire by a Czech prosecutor to the Panamanian government about the activities and bank accounts of 5 Panama foundations and 2 companies[75].

Never, in the history of foundations, whether in Panama or Liechtenstein, has a successful forced heirship claim been made. Numerous cases dealing with confidentiality, beneficiary's and creditors' rights to information, and even the sequestering of assets owned by the foundation, have been seen by the courts. But none of them has been able to challenge the validity or functionality of the foundation due to the fact that *for all legal purposes the assets held by the foundation are completely segregated from the assets of the founder. This separate class of assets may not be sequestered, garnished, or subject to precautionary action or measure, except for the obligations incurred or damages caused during the performance of the purposes or objectives of the foundation*[76].

A few days ago[77], the Panamanian Supreme Court of Justice issued their decision on a long debated case where a multimillionaire[78] died leaving a trust that had him and numerous charities as beneficiaries. In the event of his death, the trustees were to distribute amongst those charities, whose focus was feeding children in need in Panama, the $50 million trust fund that had been established. The deceased's lawyer had decided to employ a trust instead of a private interest foundation in order to satisfy his client's instructions. However, in doing so he exposed the structure to forced heirship legal provisions which dissected the trust to expose a cloaked will[79] seeking to avoid such statutory shares to which his spouse, and only heir, was entitled to. The District Court and the Court of Appeals favored the trust, however, Supreme Court overturned the decision unexpectedly and ruled in favor of the forced heir. This litigation has been scourged by controversiality and questionable decisions, but estate planners who managed to study the case shared the same view that a PIF would have been invulnerable to such attacks and would have continued to function as desired by the conceiver, leading to the largest charitable donation ever distributed in the nation's history.

5. CONCLUSION

Forced heirship is the Black Plague of the 21st Century. And with wealths and fortunes being made every second, individuals will constantly seek protection. Rich individuals, family businesses, and the likes have constantly been searching for ways to ensure the security and protection of their

[75] ibid. This is part of Alfu's magnificent exposition of Panamanian PIFs put to the test.
[76] *Panamanian Private Interest Foundation Law,* Article 11 of Law 25 of 1995.
[77] August 19th, 2010.
[78] Wilson Lucom
[79] Public Document No. 6646 from June 20th, 2005.

estates, and as such, the legal world has always provided the necessary alternatives. The real dilemma is whether to utilize an ancient institution that has upheld the same ideals and principles since its creation or to go against the tide and employ an efficient structure that will evolve with time to provide the ultimate solution. Trusts have attempted to bypass inheritance and matrimonial regime provisions for years, and have managed to successfully achieve it only a few times. Foundations on the other hand have a limited set of case law to make reference to, but the few cases that have been put to the test have produced the desired outcome. Forced heirship can be avoided through careful estate planning. Location of assets, type of legislation, individual intention, and country of domicile, are all factors that play a role in choosing which legal skeleton to build upon. In the end, those who dare cross the ocean in an Airbus 380 are better off than those in the Pinta, Niña, and Santa María[80].

[80] Christopher Columbus' first fleet of ships when venturing into the new continent.

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