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The Different Places and Roles of the Institution of the Trust in Business

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The legal institution of the trust plays a central and important role in the everyday life and in the economy of Anglo-Saxon countries. The advantages of the trust are undisputable; this flexible and cost efficient arrangement ensures substantial economic yields. The research focuses on important questions, such as the role of the trust in Anglo-Saxon legal systems, and whether the trust can be implemented in the economy with different legal arrangements and regulations based on the traditions of Roman law? Are the trust-like devices developed in the European Continental legal systems suitable to substitute the institution of the trust in business?
After several years of studying the place and role of the trust in the common law countries and the similar legal arrangements in civil law and mixed jurisdictions, we can state that – albeit in a narrower sense – other types of legal institutions can be applied to function similarly to the trust. It is noteworthy that several civil law countries, such as France, Russia, Lithuania, Georgia, Romania, Czech Republic, Hungary, San Marino recently introduced legal arrangements resembling the trust, and this trend can be also be observed in Asian countries, including the People's Republic of China, South Korea, Taiwan. The aim of the research is to present a comparative law analysis of the trust and trust-like devices, putting special emphasis on their usage and their function in business.

1. Introduction

The legal institution of use and later trust developed from equity.[2] With the weakening of feudal forms of ownership, there was growing demand to allow the tenant to transfer land to his heirs by testament or to living persons, without the need to request approval from the lord. This led to the creation of use.[3] Under the terms of use, the feoffor entrusted the feoffee with the land to the use of himself, as cestui que use, or for the benefit of persons designated by him. The feoffor could designate other users through a last will, or other preliminary measure. The land would, thus, become transferable inter vivos and in the event of death, without approval by the lord. The feoffee enjoyed legal protection against third parties.[4] Defined as the origin of the institution of use, the knights going on the Crusades entrusted their property to a trustworthy person (feoffee to use), for the benefit and in the interest of themselves and their family (cestui que use). This arrangement, however, also enabled the evasion of the feudal burdens. Approximately one hundred years after the issue of

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[2] For the relationship between equity and common law and the statute, see Hayton, D. J.: *Hayton and Marshall Cases and Commentary on the Law of Trust*. Sweet & Maxwell, London, 1991[9]. p. 7 ff. For sources in legal literature, see Pound, Roscoe – Plucknett, Theodore F. T. (ed.): *Readings on the History and System of the Common Law*. The Lawyers Cooperative Publishing Company, Rochester, 1927[3]. p. 208 ff.
[3] Hudson, Alastair: *Understanding Equity & Trusts*. Routledge, London, New York, 2013[4]. p. 15.
[4] Moffat, G. – Chesterman, M. – Dewar, J.: *Trust Law. Text and Materials*. Butterworths, London, 1998. p. 29.

the Statute of Uses (1535)[5], the concept of the use was revived with the name "trust".[6] In 1532, before the Statute of Uses, a decision was passed that the use could not be further encumbered with a use, that is, the Court of Chancery did not recognise chains of fiduciary relationships. In the 17th century jurisprudence once again focused on the trust. This is attributable to the consolidating finances of the king in the 17th century, and strengthening opposition to the prohibition of the free testamentary arrangement of real property.

The trust played very important part of the English economy from the beginnings. It was very useful for the transfer of property to avoid feudal burdens and also for preparing legal arrangement to regulate the assets of the family. The family settlement, also known as strict settlement, fulfils the function of a family entailment in English law. Between 1750 and 1914, the family settlement was a widespread legal form for the transfer and management of real property.[7] It could be established at any time, commonly on occasion of marriage or when someone reached a given age. The strict settlement served dynastic purposes, and supported the preservation of the property and political power of the landed aristocracy.

Growth of trade and industry in England picked up pace and the financial sector gained strength from the 17th century; the dominance of the agricultural industry was clearly diminishing. During the rule of the Tudors (1485-1603), it became possible to invest in joint-stock companies. The industrial revolution opened up new opportunities from the middle of the 18th century. Investments were implemented principally within the legal framework of the partnership, the deed of settlement company and the joint-stock company. The unit trust was established through the deed of settlement company.[8] The trust became a real competitor of the business companies, especially after the South Sea Bubble. The trust, as a collective form of investment, gained particular relevance in the 19th century. The changed function of the trust resulted in substantial modification of regulation. The chancery drafted investment guidelines concerning the operation of trusts to curb speculative investments. Thus, unless provided otherwise by the settlor, the trustee did not have the right to make financial investments other than in government securities or a first mortgage. The delegation of the right of representation was also regulated for brokers and agents, in case the trustee was unable to perform such duties. The trustee position was increasingly filled by professional firms.[9]

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[5] (27 Henry VIII. c. 10.).

[6] The Statute of Uses was "the starting point of modern law of uses and trusts". Holdsworth, Sir William Searle: *A History of English Law I – XVII*. Methuan & Co. Ltd., London, 1956[7]. Vol. IV. p. 409.

[7] According to contemporary records, in the middle of the 19th century, 3/4 of English properties were managed under a family settlement; recent research suggests that this ratio equalled approximately one half. Rubin, G. R. – Sugarman, David: *Law, Economy and Society 1750–1914. Essays in the History of English Law*. Professional Books Limited, Abingdon, Oxon, 1984. p. 130.

[8] Sin, Kam Fan: *The Legal Nature of Unit Trust*. Clarendon Press, Oxford, 1997. p. 8.

[9] The amateurs of the aristocracy were replaced with property managers, who were experienced in the day-to-day affairs of this business and held the professional experience required for such position. Selbig, Sabine: *Förderung und Finanzkontrolle gemeinnütziger Organisationen in Großbritannien und Deutschland. Rechtsformen, steuerliche Förderung und Finanzkontroll*e. Max-Planck-Institut für ausländisches und internationales Privatrecht. Studien zum ausländischen und internationalen Privatrecht, Band 173. Mohr Siebeck, Tübingen, 2006. p. 180.

2. Literature Review

Vast volumes of literature deal with the trust; the trust is one of the most frequently discussed and explained legal institutions. Currently the manuals of David Hayton and Alastair Hudson are particularly relevant in the description of the trust. From the point of view of comparative law, the volumes edited by Lionel Smith, Aylon Kaplon, the works of Tony Honoré, and the monograph of Maurizio Lupoi are also highly valuable.

3. Methodology

This study partly draws on the history of law and partly on economic law researches relating to the trust. Both approaches and analyses aim at producing an overall legal synthesis within the framework of comparative law, on the basis of certain forms of the trust and property management in civil law.

4. Discussions

4.1. The Functions of the Trust

When applying the institution of the modern trust, it is obviously necessary to take into account its special forms. It is beyond doubt, however, that the trust is an evergreen legal institution in Anglo-Saxon legal systems.

The trust may be structured according to the structure of the legal relationship or its purpose. The trust is a legal institution of the Anglo-Saxon legal system, characterised by a rich variety of trust types, which is capable of satisfying a wide range of social needs. For example Fratcher defines several types of trust, according to its function.[10] We can find in his list private and public purposes, protection of the property of the family, and also business purposes. The trust is a legal institute which provides protection for minors, mentally incompetent persons, management of real property, pursuing business activity, management of shares, securities etc. One of the key motives for establishing a trust is to provide appropriate legal protection of property.[11] The arguments made against the trust principally underline its threat to the transparency of property ownership.

The legal institution of the trust encompasses and manages a wide range of both social and economic situations. It is generally present in Anglo-Saxon law, while the issue of its regulation in European Continental legal systems is increasingly raised. This is why global steps have been taken toward the uniform regulation of the trust.

4.2. The Adoption of the Trust

Without the adoption of English law in some form, the rules of legal systems built on the traditions of private law in civil law systems do not permit two different legal titles to the same thing. With respect to the adoption of the trust, the premise is whether

[10] Fratcher, W. F.: *Trus*t. International Encyclopedia of Comparative Law. Vol. VI. Trust and Property. J. C. B. Mohr (Paul Siebeck), Tübingen, 1973. p. 5 ff.
[11] Grundy, Milton – Briggs, John – Field, Joseph A.: *Asset Protection Trusts*. Key Haven Publications PLC, London, 1997[3]. p. 27.

regulation with a function similar to the arrangement of the legal and equitable title can be introduced in an environment of civil law, or a different legal institution is unfit to fulfil the role of the trust, thus the regulation of the trust is only possible through the adaptation of divided ownership. On the basis of views put forth in jurisprudence, substantial arguments are made in favour of both solutions. In the Middle Ages, the Roman principle of ownership *(dominium)* had not been adopted in the north-western parts of Europe. Many different forms of ownership existed, which led to the development of the English trust.[12] In the legal systems of states recognising ownership in the tradition of Roman law, the trust was in conflict with the prohibition of the duplication and division of property.

The adoption of the Anglo-Saxon trust in countries with Anglo-Saxon legal systems evolved in parallel with the development of English law. Thus, English regulation is applied in different degrees of variation in Canada, Australia, New Zealand, Malaysia, West Indies, Ghana, Nigeria and in other territories of the British Commonwealth.[13] In countries that were not affected by the French *Code civil*, and English law exerted a certain amount of influence, the adoption of the institution of the trust did not cause major difficulties, as in South Africa, Sri Lanka, the province of Québec and Scotland.[14]

The adoption of the trust depends, to a large extent, on the legal traditions of the given country. From this perspective, countries may be divided into three groups:

- The legal system, built mainly on traditions of civil law, was significantly reformed under English colonisation (e.g. South Africa, Sri Lanka).
- The given territory is surrounded by countries with legal systems of common law, and is therefore strongly influenced to favour the adoption of the trust, as is the case in Québec and Louisiana, for example.
- In other countries, such as Jersey and Latin American countries, the trust is adopted primarily for commercial and tax considerations.[15]

The institution of the trust was adopted in the national laws of different countries in different periods and legal systems. Obviously, Scotland made early headway, introducing the trust in the 17th century. Scotland has a mixed legal system, although its property law is essentially based on civil law. The Scottish trust developed independently. It is not based on the concept of divided ownership, although it was exposed to significant English influence. In the 19th century, the institution of the trust appeared in other legal systems, including South Africa, Québec, Louisiana, Sri Lanka.[16] In the first half of the 20th century, the trust-like legal arrangements proliferated at a very rapid pace in Central and South American countries; most of these had adopted civil legal systems. Introduction of the trust, or at least trust-like legal devices in Colombia (1923), Panama (1925), Chile (1925), Mexico (1926), Bolivia (1928), Peru (1931), Costa Rica (1936), Venezuela and Nicaragua (1940),

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[12] Hahlo, H. R.: *The Trust in South Afric*a. South African Law Journal 78 (1961). p. 196.

[13] Sheridan, L. A.: *Keaton and Sheridan's The Law of Trust*. Barry Rose Law Publishers, Little London, Chichester, 1993[12]. p. 36.

[14] Bolgár, Vera: *Why No Trusts in the Civil Law?* The American Journal of Comparative Law 2 (1953). p. 208.

[15] Oosterhoff, A. H. – Chambers, Robert – McInnes, Mitchell – Smith, Lionel: *Oosterhoff on Trusts. Text, Commentary and Materials*. Thomson Canada Limited, Toronto, Ontario, 2004[6]. p. 41 ff.

[16] The adoption of the trust on a given level is mainly attributable to the fact that these countries are surrounded by countries with common law systems. See Honoré, Tony: *On Fitting Trusts into Civil Law Jurisdictions*. http://users.ox.ac.uk/~alls0079/chinatrusts2.PDF p. 1.

Guatemala (1946), Ecuador (1948), Honduras (1950). In these countries, the application of the trust (commonly called *fideicomiso*) was generally limited to the banking and financial system; regulation is based on the legal instrument of entailment. The trust was also introduced in Liechtenstein in the first half of the 20th century (1926), in the first European country not adopting the common law. The country applies mixed rules of the trust and the Treuhand, which evolved through legal practice. Japan was the first Asian country to regulate the institution of the trust in 1922. The next major date for adoption of the trust is the end of the 20th century, when countries with non-Anglo-Saxon legal systems also introduced this legal institution. South Korea introduced it in 1961, Russia in 1993 (significantly amending regulation two years later), Taiwan in 1996, People's Republic of China in 2001, France in 2007, Lithuania in 1994, Romania in 2009, San Marino in 2010, Czech Republic in 2012, Hungary in 2013.

The accelerating international trend underlying the spread and adoption of the trust in the second half of the 20th century and in the early 21st century is, however, misleading. The instruments applied in civil law systems – similar to the trust – implement the functions of the trust to a certain extent, but this is not equivalent to the adoption of the concept of dual ownership under Anglo-Saxon law. The dogmatic foundations of ownership derived from Roman law determine the private law of civil law countries to such an extent, that the different schemes of property management are not identical to the institution of the English trust. The biggest breakthrough among the different forms of regulation is the legislative regulation of the in rem (or quasi in rem) right of the beneficiary vis-á-vis third parties, which transforms the purely in personam right to the trust property into a right of an in rem nature. When taking this into account as well, we may conclude that today, two concepts of the trust are implemented: firstly, the trust in a broader sense, corresponding to the sum of different legal instruments that fulfil the functions of property management, and secondly, the trust in a narrow sense, i.e. the Anglo-Saxon trust, which is defined by equitable dual ownership.

Dual ownership defined by legal and equitable title under English law is regarded as the core element of the trust. This model is applied in the private law systems of countries with Anglo-Saxon legal foundations, such as, *inter alia*, the United States (except for Louisiana), Canada (except for the province of Québec), Australia and New Zealand. In terms of ownership, instruments similar to the trust may be divided into different groups, based on the given regulation.

We can see that the greatest resistance to the institution of the trust is coming from European countries with systems of civil law. The Hague Convention on the Law Applicable to Trusts and On Their Recognition was ratified by only five European countries with civil law systems (Italy, Netherlands, Luxembourg San Marino and Switzerland), which does not mean that the trust has been de facto directly introduced in these states.

For example in Eastern European countries the trust-like legal institutes are quite different. In Russia this legal arrangement can be characterised as a mandate or agency contract, in Georgia it is an agency contract. In the Czech Republic the regulation resembles to a separate and independent ownership of property, like the regulation in Québec. The trust property is neither property of the settlor, nor the trustee, the trust property shall be vested in its own name on account (must be

designated "Trust Fund"). In Romania the sample was the French fiducie, therefore it is a contractual relationship with some property features. In Lithuania the right of trust is an in rem right, which is quite peculiar because this right can exist beside the ownership. In Hungary mainly the German Treuhand was the model for the legislators, but strong property rights were also worked out in the fiduciary asset management contract. Two legal acts are required, one is a contract and one is the transfer of property. But we have to emphasise that the Hungarian model has additional rules in connection with the asset partitioning and tracing.

As a result of this short comparison we may state that none of these countries adapted the Anglo-Saxon trust. In Russia and Georgia the structure is basically the contract of mandate and agency, while Romania followed the French regulation and the Czech Republic the Québec model. The Hungarian regulation is also based on contract law but property law regulations are also involved. The Lithuanian solution is unique because the right of trust is an in rem right.

4.3. The Economic Advantages of the Trust and Trust-Like Legal Arrangements

As part of a common trend in the practice and literature of the United States, a parallel is drawn between the trust and legal entities, and it is often regarded as a legal entity. It is evident that in terms of function, the trust shows strong similarity to the business companies, based on the separation of property.

The business association often fulfils a function similar to that of the trust, particularly in the case of flexibly manageable companies.[17] In comparison to the many restrictions contained in legal regulation relating to business associations, the trust is significantly easier to manage and is regarded as a more liberal legal institution. Compliance with the organisational and decision-making rules applicable to business companies is often more demanding than in the case of the trust. The business trust first appeared in the state of Massachusetts in the 19th century with the express purpose of circumventing strict mandatory rules applicable to business companies.[18] The business trust is often also used for tax avoidance and tax optimisation.[19]

The advantage of the trust is that it is much more cost-effective than the legal entity, and it also allows the separation of property and limited liability.[20] Owing to this advantage, the registration of the trust is generally not mandatory in Anglo-Saxon countries, and no formal requirements apply to its establishment. The same cannot be said of business associations and legal entities.[21] I also have to emphasise, that registration requirements are applied in several states where the profit-orientated

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[17] Hansmann, Henry – Mattei, Ugo: *The Functions of Trust Law: A Comparative Legal and Economic Analysis*. 73 New York University Law Review 434 (1998). p. 472.

[18] Hansmann – Mattei: op. cit. p. 473 ff. Hoffstein, Maria Elena: *Trust*. In: Halsbury's Laws of Canada. Transportation. Trust. LexisNexis Canada Inc., Ontario, 2011. p. 514 ff. Scott, Austin Wakeman – Fratcher, William Franklin: *Scott on Trust. The Law of Trusts*. Vol. I. Little, Brown and Company, Boston, Toronto, 1987[4]. p. 3.

[19] McPherson, B. H.: *The Insolvent Trading Trust*. In: P. D. Finn: Essays in Equity. The Law Book Company Limited, Sydney, 1985. p. 142.

[20] Gambaro, Antonio: *Trust in Continental Europe*. In: Alfredo Mordechai Rabello (ed.): Aequitas and Equity: Equity in Civil Law and Mixed Jurisdictions. Jerusalem, 1997. p. 784 ff.

[21] Reid, Kenneth G. C.: *Patrimony not Equity: The Trust in Scotland*. In: J. M. Milo – J. M. Smits (ed.): Trusts in Mixed Legal Systems. Ars Aequi Libri, Nijmegen, 2001. p. 25 ff.

trusts or trust-like devices were introduced in aim to fulfill the function of the trust in the economy. The registration is obligatory for example in France, Luxembourg. Cyprus, Romania, South-Africa, Liechtenstein, China, Japan, San Marino, Hungary etc.

The trust is also a useful legal instrument for the protection of the interests of a larger number of beneficiaries. In Continental legal systems, the association or the business company is used as an appropriate legal instrument for this purpose. Some argue that the function of the trust can essentially be fulfilled through a legal entity in systems of civil law.[22]

Within the context of economics, a company does not necessarily mean a legal entity, but rather a business organisation.[23] According to Henry Hansmann, Reinier Kraakman and Ugo Mattei, the trust is a de facto legal entity. They argue that the separation of property in the case of the trust is unmanageable on the level of contracts. As a general rule, the personal creditors of the trustee may not assert claims for the trust property; such separation of property in trust law is not contradictory, but rather expresses the trust property's independent entity. The treatment of the trust as a legal entity has the advantage of rendering it much more straightforward for jurists of civil law.[24] In the case of the trust, however, the rights of the beneficiary relating to the trust property are much more direct than the claim of the legal entity's member or owner to legal title, which may only be enforced indirectly against the legal entity.

Creditor claims and claims to legal title in relation to the trust cannot be simply mapped on the level of contracts. A contractual arrangement corresponding to the trust involves considerably high agency costs. Two persons appear in the legal relationship between the trustee and the creditors: firstly, the trustee vis-á-vis his personal creditors, and secondly, the trustee vis-á-vis the creditors of the trust property. The trustee may contract with third parties either in his own name, or as representative of the trust property. Such separation of property is similar to the approach applied in connection with the legal entity criterion, i.e. the trust is deemed to be a de facto independent entity. It therefore even qualifies as a legal entity under the laws of some states.[25] In many commercial transactions the trust and the legal entity are deemed to be equivalent legal forms. In Anglo-Saxon law, unincorporated associations (clubs, societies) are not legal entities, yet they are deemed to be entities. Outside of common law systems, however, the trust is not recognised as a legal entity. In the United States, the trust is implicitly treated as an independent entity. Based on the model of English law, the trustee was deemed to assume personal liability in both contractual and non-contractual relationships up to the early 20th century. This changed in American law by way of the Uniform Trust Code (UTC)

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[22] Waters, Donovan W. M. – Gillen, Mark R. – Smith, Lionel D. (ed.): *Water's Law of Trusts in Canada*. Thomson Canada Limited, Toronto, Ontario, 2005[3]. p. 16.

[23] Lau, M. W.: *The Economic Structure of Trusts*. Oxford University Press, Oxford, 2011. p. 61. For correlations between the separation of property and the entity of the trust, see Sitkoff, Robert H.: *Trust Law as Fiduciary Governance Plus Asset Partitioning*. Harvard John M. Olin Center for Law, Economics, and Business. Discussion Paper No. 711. http://ssrn.com/abstract=1962856. p. 434 ff.

[24] Lau: *op. cit.* p. 62.

[25] The National Conference of Commissioners on Uniform State Law drafted the Uniform Statutory Trust Entity Act; Sections 302 and 304 of the act define the trust as a legal entity. See Rutledge, Thomas E. – Habbart, Ellisa O.: *The Uniform Statutory Trust Entity Act: A Review*. The Business Lawyer Vol. 65 (2010). http://ssrn.com/abstract=1628674. p. 1055 ff.

and the Restatement Law, and the trust is treated as a quasi legal entity. At the same time, the status of the trust in America is not fully equivalent to that of legal entities.[26]

The trust is more porous than the legal entity, although the trustee's personal creditors cannot claim satisfaction from the trust property of a trust, either. The creditors of the beneficiaries may assert claims for the trust property from the position of the beneficiary. The discretionary trust and the spendthrift trust are exceptions. In many cases, the limited liability of the trustee is regarded as a rule similar to the case of the entity. Under contract law it is also possible to conclude a contract, in which the parties set out and limit collateral for the fulfilment of contractual obligations. In the case of the trust, however, this does not require the approval of the other party; limited liability is applied by law. It is also possible, however, for the trustee to conclude contracts in his own name within the framework of managing the property. In such a case, his liability obviously also extends to his personal property. In the case of a legal entity's representative entering into a contract, we assume that he essentially executes the legal act in his own name.

Worthington summarises the advantages of the trust in six points. The beneficiary has the right to enforce claims, whereas this would not be possible in the case of a gift, for example. Secondly, property may be owned by persons, who would otherwise be prohibited from doing so under common law (e.g. in cases of incompatibility). Thirdly, rights can be distributed among the beneficiaries in time. Fourthly, ownership and the management of property may be separated from each other. The fifth and sixth advantages are the separation of property, and the independent legal status of the trust property.[27]

According to a general principle of law concerning organisations, the property of the organisation does not constitute the property of the owners or shareholders; shareholders only hold indirect rights with respect to the assets of an organisation. In the case of the trust, the legal situation is somewhat different. The rights of the beneficiary in respect of the trust property are significantly more direct than the rights of the shareholder in respect of the company's assets. Under English and American laws, the beneficiary has a fundamental right to claim distribution of the trust property, such claim being of an *in rem* nature. Only bona fide purchasers for value are exempted from this rule. Such a right against third parties is not granted to members in relation to legal entities.

In the process of implementing the trust under civil law, the *in personam* and *in rem* models are distinguished. In the *in personam* contractual model, the property management contract entered into by the parties uniquely sets out the separation of property. The *fiducie* in Luxembourg and the *Treuhand* in Switzerland, Germany and Austria are examples of the above. In the ownership model, the property of the persons is separated; the trust property actually constitutes the trustee's subsidiary property subject to special legal qualification.[28] The property law model offers two solutions. In the first case, the trust property is without entity (pure patrimony by appropriation); in the other case, the trust property is deemed to be a legal entity. In the first case, the trust property is not actually owned by anyone.[29] Lau argues that a

[26] Lau: *op. cit. p*. 66.
[27] Worthington, Sarah: *Equity*. Oxford University Press, Oxford, 2006[2]. p. 73 ff.
[28] Lau: *op. cit.* p. 76.
[29] Quebec Civil Code Art. 1261.

legal entity is a more adequate legal instrument for managing the trust property, based on the model of the foundation. Perhaps the most important argument made in favour of the legal entity is administrative manageability.

5. Conclusions

Overall we may establish that the trust is not a relic of feudal property laws; in the modern economy, it offers an adequate legal instrument for the fulfilment of many important economic and private objectives. The biggest problem facing Continental European legal systems in attempts to apply this legal institution is that they essentially treat ownership as a uniform category, and neither the trustee, nor the beneficiary are simultaneously deemed to hold rights in rem. Rules of the contract, particularly those of agency, do not essentially offer viable options due to the relative structure of their legal relationship.

On the other hand the trust-like devices may fulfill the functions of the trust, if the regulation ensures asset partitioning relating to the creditors of the parties in the legal relationship. And if the separation of the property can be achieved then the trust-like legal arrangements are real competitors of the business companies, especially if these are not obliged to be registered.

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