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Articles

Cracking the Brazil nut: trusts in Brazil

Henrique Vargas Beloch* and Geoffrey Cone**

Abstract

An examination of the use of trusts for Brazilian residents or for holding assets in Brazil or overseas.

The fiducia, a civil law form of trust, was recognized by civil law countries until the late 18th century. These structures were abolished in France in 1792, and this was re-enforced by the Napoleonic Code.[1] As the Napoleonic Code was used as a model by most Latin American countries, the trust in its classical form or common law form was never developed in that region.

Although Brazil had closer economic relations with Britain than France at that time, it still did not adopt any comparable Anglo-Saxon laws. Even now Brazil is unfamiliar with trusts, although the financial and legal communities are learning more about this common law creation. When dealing with international structures or high net worth individuals and international families, it is not uncommon to see advisors eagerly recommending—or clients curiously asking for—trusts as a solution to their needs, whether for estate-planning purposes, asset protection, or otherwise. Unsurprisingly, however, there are still misunderstandings.

So amidst this growing interest for trusts, it is important to analyse if and how they may in fact be suitable for Brazilian residents or for holding assets in Brazil or overseas, especially as the country stands out as an emerging power in a globalized economy.

The first thing to be noted is that, beyond any doubt, a trust cannot be set up under Brazilian law. As in most romanistic systems, the trust does not exist in statute and nor is there any other legal instrument that has all the characteristic elements of a trust; there is even nothing like the *fideicomisso* that exists in Argentina and other Latin American countries; no similar attempt has been made to 'nationalize' the trust.

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Brazil has a limited *fideicomisso* that could be seen as a form of inheritance trust. This limited rule provides that a testator can substitute one or a number of persons or heirs where a primary heir cannot or will not accept his or her inheritance. However, this is a generally restricted power, and does not provide the freedom of disposition found at common law and, other than the name, it bears little resemblance to the homonym of its Latin American neighbours.

Other concepts may resemble or contain some features common to a trust, but none is an adequate substitute. For example, by means of a *usufruct* a

*Henrique Vargas Beloch, Barbosa, Müssnich & Aragão, Av. Almirante Barroso, 52–33° andar, 20031-000, Rio de Janeiro. Tel: +55 21 3824 5851. Email: hvb@bmalaw.com.br.

**Geoffrey Cone, Cone Marshall & Co, Parnell House, Level 3, 280 Parnell Road, Auckland 1151, New Zealand. Tel: +64 9 307 3950. Email: gcone@conemarshall.com.

1. Malumian, *Trusts in Latin America* (Oxford 2009).

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person can transfer to another the right to the benefits and products yielded by an asset, while keeping to himself the 'bare property'. But among other differences, the person in possession of the property subject to the usufruct is the beneficiary himself, acting in his own interest and not for a third party.

In the 1960s, banking laws introduced the fiduciary transfer for purposes of guarantee (*alienação fiduciária em garantia*), by which the debtor transferred temporary title to the financed property to the lender as collateral, retaining direct possession and reacquiring the movable property upon paying the debt. Since the 1990s, laws aiming at stimulating real estate activity and markets, ranging from finance, investment funds, and development projects, defined *fiduciary property* and permitted or implied the creation of a detached patrimony (*patrimônio de afetação*) segregated from the rest of the manager's or developer's own assets and liabilities. Barely noted, but equally important, is a fiduciary regime instituted by Brazil's Corporation Law which regulates the custody of fungible shares, referring to an effective owner as opposed to a fiduciary owner.

These fragmented concepts adopted in response to occasional economic needs are still far from an institutionalization of the fiduciary agreement or trust, but at least indicate Brazil's growing ability and openness to translate certain aspects of the trust into its own laws.[2]

Academic commentaries admit the concept of a fiduciary transaction. For example, Santos notes that:

> Although fiduciary transactions bear some resemblance to disguised acts (sham), they differ in that they [fiduciary transactions] are effectively executed between the parties but do not add to the transferee's assets, since this is not their purpose. In the fiduciary transaction, the transfer of rights and assets does in fact occur, but the transferee is deprived of the capacity to exercise certain prerogatives, thus the substance of the transferred right/assets remains intact.[3]

Civil law author Arnoldo Wald,[4] in seeking local alternatives to the trust, also points out to the *comissão mercantil* or business mandate. Dating back to the Commercial Code of 1850, this type of contract allows the agent (*comissário*) to trade goods in its own name and stead but in the interest of the principal (*comitente*). This two-party relationship, strictly commercial, is distant in theory and practice from the trust with its multiple uses, but is very similar to the limited partnership model that is derived from French and Italian law, and found in a number of common law jurisdictions.

There is no limitation under Brazilian private law, from a contractual perspective, to the execution of an agreement pursuant to which a party undertakes to hold and administer assets conveyed to it in a fiduciary nature and to do so according to certain standards and purposes. After some initial academic confusion with disguised acts (shams), scholars and courts have started to generally accept the fiduciary agreement as a lawful, albeit atypical, contract. Pontes de Miranda,[5] Carvalho Santos[6] and Orlando Gomes,[7] among the most prominent civil law jurists in Brazil, have written about the subject.

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2. In a recent article comparing the Brazilian fiduciary property to the trust, Raphael Manhães expresses:

> In this sense, in an analysis which is limited to the static or formal quality of the trust it would be necessary to recognize that it would be condemned to the limits of Anglo-Saxon law. However, that analysis fails in one essential point: to consider the legal phenomena only in its factual-normative aspects, discarding that which is fundamental to the trust, in other words, the values underlying its creation. (free translation by the author of the article)

(*Análise da 'aclimatação'do trust ao Direito brasileiro: o caso da propriedade fiduciária*. Revista de Direito Privado no 42, April/June 2010.)

3. João Manuel de Carvalho Santos, *Código Civil Brasileiro Interpretado, Principalmente do Ponto de Vista Prático* Vol II (Freitas Bastos, Rio de Janeiro 1988) 385.

4. Arnoldo Wald, *Algumas Considerações a Respeito da Utilização do Trust no Direito Brasileiro*. Revista de Direito Mercantil, Industrial, Econômico e Financeiro no 99, July/September 1995.

5. Pontes de Miranda, *Tratado de Direito Privado*. Vol III (e LII Bookseller, Campinas 2000).

6. Santos (n 3).

7. Orlando Gomes, *Contrato de Fidúcia ('trust')*. Revista Forense no 211, July/September 1965.

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Miranda, for example, states:

> Despite being a juristic act whose mechanics are based upon principles that are peculiar to British law, it is possible to adapt the trust to other legal systems which are not based upon those same principles. Notwithstanding the resistance offered by legal scholars of Roman influence, social needs stemming from the economic sector authorize the introduction of the trust into those legal systems, along with the necessary adaptations, due to its undeniable usefulness.... In short, it is acceptable that such legal systems admit the prescription of a juristic act through which one person is trusted with the ownership of assets with the mission to manage them, in favor of a third party, according to the instructions received, and remains obligated nevertheless to deliver such assets to the beneficiary at a certain time or under a certain condition.[8]

At one point there was even a specific bill introducing a *fiduciary agreement* but it did not survive through the legislative process. However, despite being similar to a trust, the effects of such a contract would be insufficient as compared to the Anglo-Saxon model. Most importantly, it would not have provided an *in rem* right for a beneficiary who was not a party to the contract. The transfer of property operated irrespective of its purpose or motivation without giving rise to any special or fiduciary title, other than the obligations undertaken in the contract. Without power to claim the asset back from a bona fide third party, all that the beneficiary or original proprietor would be left with is a claim for damages. Furthermore, the property would be subject to claim by the creditors of the party to whom it was transferred.

In summary, three main obstacles make the trust unfeasible in the Brazilian legal system.

The first and most important is that title to property in Brazil is deemed singular and undividable. Most commentators highlight this aspect and find hard to conceive in civil law tradition an equitable/beneficial right detached from the legal ownership. This is the conclusion reached, among others, by Judith Martins[9] and Melhim Chalhub.[10] Indeed, in a condominium each co-owner holds exclusive and full title to a fraction of the asset. In a usufruct, the right of use and enjoyment is assigned but title remains solely in one party. The right of entitlement, being exclusive, is traditionally defined as the right to repel any actions or interference by strangers over the property held.

Secondly, *in rem* rights in Brazilian law, as such enforceable before third parties—ownership, usufruct, pledge, etc—are *numerus clausus* under statute, meaning that no contract may give rise to new or different types of rights over property, whether movable or immovable, other than a purely personal or contractual right.

Lastly, the creation of a segregated and protected patrimony in the name of a person or entity but unavailable to their creditors would require a specific law, providing an exception to the general principle contained in the Code of Civil Procedure, by which a debtor is liable with the entirety of his assets, save as otherwise provided by law.

Notwithstanding, the fact that a trust as known in common law countries may not be instituted in Brazil does not mean that Brazil would not recognize a trust validly settled outside of its borders. Even though Brazil is not a signatory to the Hague

8. Miranda (n 5) 146 and 147.
9. Judith H Martins Costa, *Os Negócios Fiduciários - Considerações Sobre a Possibilidade de Acolhimento do 'Trust' no Direito Brasileiro.* Revista dos Tribunais no 657, July 1990.
10. Melhim Namem Chalhub, *Negócio Fiduciário* (Renovar, Rio de Janeiro 1998).

Convention on the Law Applicable to Trusts and their Recognition of 1985, according to Brazilian international private law, all acts, judgments and laws of another country are effective in Brazil, provided they do not offend national sovereignty, public order, or public decency. This is provided for by Article 17 of the Introductory Law to the Civil Code (Decree—Law 4687/42).

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A case concerning a New York trust created by a Brazilian telecom company was considered by Comissão de Valores Mobiliários, the Brazilian securities commission.[11] Rejecting the arguments raised by minority shareholders filing a complaint against the company, the commission decided that the trust in this case, including the resulting 'dichotomy of property', was fully effective in Brazil as it violated neither national sovereignty nor public order or decency. In that case, the assets (rights) under trust, although intangible, were directly connected to Brazil. A more homely example of this principle is found in *Netto v Thornton,*[12] 'where a Brazilian established a trust in New York. The trust affected his wife's right to inherit. It was held in New York that the trust was valid according to New York law, and this was also accepted by the Brazilian court.

Nevertheless, it is still unadvisable to directly place in trust assets located in Brazil, especially real estate, given the potential limitations on the trust's effectiveness or at a minimum the uncertainties on how it would be faced by Brazilian authorities. Normally, Brazilian assets would be first conveyed to an offshore company or other entity (such as a limited partnership) and the trust would receive the shares or participation in these entities. As far as Brazilian residents are concerned, trusts are usually a better option if dealing with assets already outside of Brazil, which has advantages for members of a Brazilian family who live outside of Brazil, or persons and families who are about to migrate to Brazil.

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When the settlor and/or the beneficiaries are Brazilian citizens, even if the assets under trust are abroad, the tax implications will play a major role in choosing the best structure for estate planning. Due to the fact that the trust is not defined by Brazil and there is a general unfamiliarity with its key characteristics, the direct transfer of assets to the trustee by a resident might be taken for a donation and be subject to gift tax (gift tax being a tax levied by each Brazilian state, and which ranges between 2 per cent and 8 per cent). There is also a danger of a withholding tax that can range from 15 per cent or 25 per cent if a tax haven is involved. If a listed tax haven is involved, higher rates will apply.

Due to the fact that the trust is not defined by Brazil and there is a general unfamiliarity with its key characteristics

Subject to the problems in dealing with a tax haven jurisdiction, in general the better approach is to adopt the procedure by which Brazilian assets are introduced to a company or other legal entity based overseas, before the settlement of property into a trust. In such a case it is likely that these taxes would not apply or be substantially reduced. In relation to distributions later made by the trust directly to Brazilian beneficiaries, there is no certainty as to whether tax authorities will treat such funds as income earned by a Brazilian resident, which would be taxed at a

11. Proc CVM RJ2005/0364.
12. 71 8 F Supp, 122 [SD NY 1989].

rate of between 7.5 per cent and 27.5 per cent, or as a gift, subject to the gift tax rates mentioned above, depending on the state where the beneficiary is domiciled.

The rules on community property and succession should also be mentioned. These laws are of public nature and as such cannot be altered by the parties. Under Brazilian succession law, descendents, spouse, and predecessors are deemed legal heirs and, subject to a certain order of preference, have an indivisible right to at least 50 per cent of the deceased's estate. This limitation applies not only with respect to wills but to any acts of disposition during the life of the donor.

The creation of a trust by a resident, which exceeds these limits and disregards the legal heirs, could arguably be annulled by national courts on the grounds that it violates the provisions of federal law. However, where there are no minors involved, the public attorney's office is unlikely to be seen as a legitimate claimant and only the parties concerned could file an action to that effect.

Where the settlor is a foreign company or similar entity, these constraints should not apply to the extent the entity is not viewed as a means to circumvent the restrictions.

Likewise, if the assets transferred into a trust are part of community property, the rights of the spouse who is disadvantaged will be protected by local courts. Whatever is received through donation or inheritance does not form part of community property under the so-called legal regime, but there may be a risk that beneficial interests received from trust will accrue to community property of the beneficiary given the peculiar nature of the distribution.

In summary, the Anglo-Saxon trust, although not unknown in Brazil, is still the subject of domestic uncertainties. It can be safely assumed that since Brazil now takes its place as a world economic power, the conceptualization and acceptance of the trust in Brazil will soon be commonplace. Brazil will accept and recognize foreign trusts, but care must be taken in introducing property to these trusts and making distributions. Notwithstanding this, properly handled, the Anglo-Saxon trust, when coupled with other structures can be an innovative planning and commercial tool for Brazilian clients.

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In brief

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An examination of the use of trusts for Brazilian residents or for holding assets in Brazil or overseas.

Cyprus international trusts—A giant leap forward: the proposed amendments to the International Trusts Law 1992

Elias Neocleous and Toby Graham

Cyprus' international trust regime was introduced by International Trusts Law 1992 to strengthen its appeal to settlors beyond its borders. This article examines recently published proposals to amend this legislation. Amendments include changes to the definition of international trusts; clarify the circumstances in which validity can be called into question; introduces perpetual trusts; amends the definition of charitable purposes; extends trustees' investment powers; extends circumstances in which the court can approve a variation of trust; clarifies when disclosure can be given and the documents that might be disclosed; and deals with jurisdiction of Cypriot courts.

Cut your *cloth* to suit your coat: the taxation of foundations in Malta

Anthony Cremona

Following the enactment in 2007 of the Second Schedule to the Civil Code,[1] which codified the rules on foundations in Malta (and built upon them considerably), an appropriate legal framework which would allow for growth in the use of foundations in Malta was thereby set up. Unlike the clarity achieved with regard to the nature of foundations (as a result of the enactment of the Second Schedule), the fiscal aspects concerning the tax treatment of foundations remained veiled in a cloud of uncertainty at the time. The shortfall has now been addressed through the enactment of regulations on the tax treatment of foundations entitled 'Foundations (Income Tax) Regulations, 2010' which came into effect by virtue of Legal Notice 312 of 2010 (the 'Foundation Tax Rules').

The Panama trust in international tax planning

Eduardo González Garay

This article outlines the various commercial and private uses of trusts in Panama, as well as the position on taxation. The rules governing establishment, administration and taxation of trusts have recently been modernized, and Panama has had a number of legislative tax initiatives establishing the regulatory framework for the adoption and enforcement of Double Taxation Treaties, 10 of which have been signed so far.

Tax reforms in the United States

Suzanne M. Reisman

A round-up of the latest tax developments in the US affecting trusts and trustees.

1. Act XIII of 2007 which introduced the Second Schedule to the Civil Code, Chapter 16, the Laws of Malta.

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Tracing into improvements, debts and, overdrawn accounts

Mark Pawlowski

This article seeks to clarify the extent to which the right to trace money in equity into the hands of an innocent volunteer may be defeated by the latter's use of the money to make improvements to property, pay off debts or make payments into an overdrawn account. The position is examined in the light of a number of English cases.

Court of Appeal in *Pitt* and *Futter* puts the so-called *Rule in Hastings-Bass* out of its misery, but leaves a loose end that is bound to cause bother unless the Supreme Court ties it off

Tony Molloy QC

In the June 2009 Issue, Tony Molloy submitted that the so-called Rule in *Hastings-Bass* had nothing to do with the case of that name; that it was insupportable in principle; and that, like *Henty v Schroder* and *Lister & Co v Stubbs*, each of which bedevilled the law for about a century, it badly needed putting out of its misery. Largely for the reasons he advanced in that article, the Court of Appeal has almost done the job, but has left the corpse still twitching, and in need of finishing off by the Supreme Court.

Case notes

The Court of Appeal Removes the Safety Net: *Pitt v Holt; Futter v Futter* [2011] EWCA 197

Richard de Lacy QC

An examination of the Court of Appeal's recent decision in *Pitt v Holt; Futter v Futter* [2011] EWCA 197.

'A Regrettable Blunder': *Marley v Rawlings* [2011] EWHC 161 (Ch)

Alexander Learmonth

This case raised an interesting (and, to an extent, novel) point of principle: could the power to rectify a will under section 20 of the Administration of Justice Act 1982 be used to cure a defect of execution of a will? Could such an error ever be categorized as a 'clerical error'?

How difficult is it to gift a share? *Shah v Shah* [2010] EWCA Civ 1408

William McCormick QC

This case note looks at the recent decision in *Shah v Shah* in which the appellant sought to recall this gift on various grounds including mistake and misrepresentation. Among the points taken by the appellant was that certain events should be construed as an attempt to make an immediate gift and which attempt had failed and which equity would not 'perfect' by way of the imposition of a trust.

Book review

International Trust Laws

Reviewed by Toby Graham