1. History of Trusts.

Trusts have been creatures of English law since the 14th Century. Many scholars consider them the crowning achievement of English jurisprudence. Most historians find the antecedents of trusts in the doctrine of uses in England, and efforts to avoid restrictions on transfers of real estate – both limitations as to heirs who could receive title to realty, high taxes payable to the Crown upon actual transfer of legal title to land and, if the transfer was defective, risk of forfeiture of title to the Crown. Maitland, *The Origin of Uses*, 8 Harv. L. Rev. 127 (1894). At the beginning, then, trusts were used for dividing estates in real estate, and facilitating the donor’s testamentary plans in the face of the laws of primogeniture and other restrictions imposed by the Crown on transfers of land, which constituted most of the wealth of medieval society. John Langbein suggests that well into the 19th Century, trusts by and large were still used in England as instruments of conveyancing, and that only in the last 150 years do we find developing the widespread use of trusts to manage family fortunes consisting of assets other than land. Langbein, *The Contractarian Basis of The Law of Trusts*, 105 Yale L.J. 625 (1995), at 633 (“Langbein”).

While common law scholars point to trusts with pride, in recent years legal scholars on the Continent have traced the history of trusts back further, and shown their civil law roots. Maurizio Lupoi has argued strenuously that the origins of 13th century English “uses” and 14th century English “trusts” can be found in Continental antecedents. He points to Roman law, the Code of Justinian, and to Medieval German and Dutch sources, as the intellectual underpinning of trusts, continuing in modern times through the German Treuhand, and the Spanish fideicomisso, and the Italian fondo patrimoniale. Lupoi, *The Recognition of Common Law Trusts and Their Adoption in Civil Law Societies*, 32 Vand. J. Transnat’l L 967 (1999) (“Lupoi(a)”).

Scholars suggest that the French Revolution ended similar efforts at dividing ownership in France, and ultimately throughout Europe and South America through the influence of the subsequent Napoleonic Code, because “divided property rights came to be considered characteristic of feudalism.” Henry Hansmann and Ugo
Mattei, *The Function of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434 (1998), at 442 (“Hansmann and Mattei”). That is, France had not yet quite made it to the trust, but it was gradually adopting the use and divided ownership, before it was swept aside by the Revolution.

Yet other scholars suggest that while the English and Continental systems are different, much the same goals with respect to limiting interests in property can be obtained today under our different legal systems. John Merryman notes that in Anglo-American law, one can have several estates or interests in property – co-tenants, tenant for years, life tenant and remainderman – all of which can be alienated. In contrast, he suggests, because civil law (perhaps because of the French revolution) believes in unitary ownership of land, the ownership of land is like “a box”, with the owner being whomever is in possession of the box. But the owner can grant interests in the land – usufructs, tenancies for years, even remainders. The holder of the remainder interest: the “naked title”: is the “owner” of the land, but any transfer of naked title is subject to the encumbrance of other interests in and rights to enjoy the land, even if those rights of enjoyment don’t constitute property interests in civil law as they do in common law. Merryman, *Ownership and Estate (Variations on a Theme by Lawson)* 48 Tul. L. Rev. 916 (1974), at 927 (“Merryman”).

This is not the forum for an exhaustive study of the comparative history of trusts in England and America and their civil law counterparts. But this is an area of the law which has been receiving extensive and quite thoughtful attention in the past 20 years, and is worthy of further attention for purposes of our examination of the U.S. tax treatment of civil law analogies to the trust. I would suggest only that if it serves the same purpose as a trust, functions in most ways like a trust, and arises from a common genesis hundreds of years ago, why not tax it as a trust?

If, as John Langbein suggests, trusts are essentially contracts between the settlor and the trustee for the benefit of the beneficiaries, Langbein, at 645, then why not tax a contractual relation which is enforced by a Swiss court as a trust? And if a modern, widely held investment management trust is essentially a contract to manage assets, Langbein, at 643, why not tax similar structures similarly, whether or not they are called “trusts”?

Indeed, Hausmann and Mattei suggest that the role of trusts in intrafamily wealth transfers is today “relatively trivial”, but that the role of trusts as pension funds and mutual investment funds is “enormously important”. Hansmann and Mattei conclude that trusts do add value to agency and corporate relationships, primarily to shield assets from claims of the manager’s (trustee’s) creditors, and that their use should be encouraged in civil law countries. Hansmann and Mattei, at 455-8. As we will see in civil law contexts below, banking and investment company lawyers have seen great virtue and utility to trusts, even if civil law property lawyers have not, and the use of trusts is rapidly growing on the Continent.
For all of these reasons, we are likely to see more and more civil law “trusts”, and it will be important to determine how they should be treated for U.S. tax purposes.

2. The Internal Revenue Code’s Definition of a Trust

The Internal Revenue Code nowhere defines a trust. Sections 7701(a)(30) and (31) detail the tests under which a trust will be determined to be a domestic trust (7701(a)(30)(E)) or a foreign trust (7701(a)(31)), but don’t define trusts.

The Internal Revenue Code deals with all kinds of trusts. Subchapter J of the Code alone speaks of:

- Electing Small Business Trusts (§ 641(c))
- Pooled Income Funds (§ 642(c)(5))
- Cemetery Perpetual Care Trusts (§ 642(i))
- Foreign Trusts (§ 643)
- Revocable Trusts (§ 645)
- Simple Trusts (§§ 651 and 652)
- Complex Trusts (§§ 661 and 662)
- Charitable Remainder Trusts (§ 664)
- Accumulation Distribution Trusts (§§ 665-668)
- Grantor Trusts (§§ 671-679)
- Marital Property Trusts (§ 682)
- Trusts as Exchange Funds (§ 683)
- Funeral Trusts (§ 685)

Sprinkled throughout the rest of the Internal Revenue Code are at least these other kinds of trusts:

- Employee Benefit (Pension) Trusts (§ 401).
- Real Estate Investment Trusts (§ 856).
- Charitable Trusts (§§ 170, 509, 511 and 4947(a)(1)).
- Common Trust Funds (§ 584(a)).
- Electing Small Business Trusts (§ 1361(e)).
- Qualified Terminable Interest and Domestic Trusts (§§ 2056 and 2056A).

Subtitle I of the Code, Sections 9501 through 9511, give us a whole series of special trust funds like the Black Lung Disability Trust Fund and the Vaccine Injury Compensation Trust Fund, all established by the Treasury.

And let’s not forget the still uncertain responsibilities thrust upon foreign trusts by the provisions of the Foreign Account Tax Compliance Act in Sections 1471-1474.
Clearly trusts are extremely flexible and approach the ubiquitous under the Internal Revenue Code, but they aren’t defined in the Code. Indeed, some of the very utility of trusts in the modern commercial world is demonstrated by this omnipresence in the Internal Revenue Code.

The place for definitions of entities is the Treasury Regulations under Section 7701, in particular Treasury Regulations §§ 301.7701-1, 2, 3 and 4.

The first necessity is that an organization — a corporation, a partnership, a trust, an association, a joint venture — be recognized as an entity separate from its owners. Treas. Reg. § 301.7701-1(a)(1). It is the recognition of a trust as a separate entity from the trustee that civil lawyers now find so desirable, as we’ll see below, because it protects trust assets from the claims of the Trustee’s own creditors. But in the first instance, classification of an arrangement as a separate entity for income tax proposes is a question of United States Federal tax law, and not a question of local law. Treas. Reg. § 301.7701-1(a)(3). “Mere co-ownership of property that is maintained, kept in repair, and rented or leased, does not constitute a separate entity for Federal tax purposes.” Treas. Reg. § 301.7701-1(a)(2). The focus here is upon contemporaneous co-tenancies, such as tenancies in common, but the same principle applies to life tenancies, and thus to usufructs, as we’ll see below.

If an organization is deemed to exist as a separate entity for Federal tax purposes, the next inquiry is whether the entity exists to carry on a trade or business and has associates. Morrissey v. Commissioner, 296 U.S. 344, 357 (1935). If it does, it will be taxed as a corporation (association) or as a partnership. If the entity exists in order to hold and invest property, but not to conduct a business, and doesn’t have associates, it will be taxed as a trust. Morrissey involved a group of investors who pooled their money under a trust instrument, named trustees who could accept investments from additional beneficiaries, and went into the business of developing golf courses in Los Angeles under the name “Western Avenue Golf Club”. The “beneficiaries” held transferable share certificates. In this seminal decision, the Supreme Court held that associations, taxable as corporations, shared six characteristics: associates, an objective to carry on business and divide the gains therefrom, continuity of life, centralization of management, limited liability, and free transferability of interests. The Supreme Court found that trusts shared the last four characteristics, but lacked the first two, and taxed Western Avenue Golf Club as a corporation. Under the subsequently enacted Treasury Regulations which were in effect until 1997, these two characteristics, having associates and carrying on business for profit, together became the distinguishing factors between associations and trusts. Prior Treas. Reg. § 301.7701-2(a)(1) and (2) (Revised 1996). If either factor was missing, the organization was a trust. Estate of Bedell Trust v. Commissioner 86 T.C. 1207 (1986); Elm Street Realty Trust v. Commissioner, 76 T.C. 803 (1981), acq. 1981-2 C.B. 1.

Treasury Regulations § 301.7701-2 sets forth those business organizations that are per se to be taxed as corporations. Included is a list of 82 types of business
entities from throughout the world that will be taxed as corporations. Treas. Reg. § 301.7701-2(b)(8).

Treasury Regulations § 301.7701-3, adopted in 1997, contains the “check the box” rule by which the owners of a business entity may elect to have it taxed either (i) as a corporation or as a partnership if the entity has two or more associates, or (ii) as a corporation or as a disregarded entity, all of whose income is taxed directly to the owner, if it is a proprietorship with only one owner. Treas. Reg. § 301.7701-3(a). With respect to foreign entities, an election may be made if the entity is not deemed to be a corporation per se under Treas. Regs. § 301.7701-2. If it is eligible to elect, but does not do so, it will be taxed as:

(a) a partnership if it has two or more members and at least one member does not have limited liability;

(b) an association if all members have limited liability, or

(c) disregarded as an entity separate from its owner if it has a single owner that does not have limited liability. Treas. Reg. § 301.7701-3(b)(2)

These are the default classifications which govern the taxation of entities which do not affirmatively choose how to be taxed.

The check-the-box election applies for all tax purposes, including estate tax. Treas. Reg. § 301.7701-3(a). But it only allows an election between partnership and corporate tax treatment. The check-the-box regulation applies only to “business entities”, and not to trusts. Treas. Reg. § 301.7701-3. Trusts are defined in the Regulations as arrangements for the management of property, not for the conduct of a business. The Regulations provide:

In general, the term “trust” as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the
discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit. Treas. Regs. § 301.7701-4(a).

The Regulations then exclude several categories of trusts from treatment as trusts for tax purposes. Business trusts, although trusts for property law purposes, are taxed as corporations because they conduct a business. Treas. Reg. § 301.7701-4(b). Investment trusts are to be taxed as trusts only if the trustee has no power to change the investments. Treas. Reg. § 301.7701-4(c). Liquidating trusts are to be taxed as trusts only if their existence is not prolonged. Treas. Reg. § 301.7701-4(d).

The point of this is that while the Regulations on their face speak of “chancery or probate courts”, and appear to contemplate traditional family estate planning arrangements, tax treatment as a trust is in no way limited to classic family planning vehicles. Clearly the Internal Revenue Code is allowing trust treatment to a broad class of public investment vehicles. The issue is whether the organization is primarily one established to conduct a business, in which case it will be taxed as a corporation or partnership under Treas. Regs. § 301.7701-2 or 3, or to protect and conserve property for the benefit of beneficiaries who cannot share in the discharge of the responsibility, in which case it is taxed as a trust under Treas. Regs. § 301.7701-4.

Because the Regulations speak consistently of the “trustee”, it would seem easier to have an entity qualify as a trust for tax purposes if the manager is called the “trustee”. However, particularly for a foreign entity which uses different terminology, there should be no necessity that the manager be called a trustee. The focus of Treas. Reg. § 301.7701-4 is not that the manager have fiduciary responsibilities but rather that: (1) the manager have the responsibility to conserve, invest and protect the property of the entity, and not have the responsibility to conduct a business, and (2) that the beneficiaries not have any power to participate in the discharge of the manager’s investment responsibilities, and thus not be associates in a business enterprise. Again, a trust is not an entity organized to conduct a business, and does not have associates. Morrissey v. Commissioner, 296 U.S. 344, 357 (1935).

The essence of a trust for income tax purposes is that it is taxed as a modified conduit under the principles of Subchapter J of the Code. Because a trust is an entity taxed as such, it will be taxed upon income it does not distribute. This is because by definition the beneficiaries are passive, and don’t participate in the affairs of the trust, and so should not be taxed on income they don’t receive. At the same time, because a trust manager is not conducting a business, there should not be a separate entity level of taxation imposed upon a trust if it is distributing all of its income to the beneficiaries.

The many cases involving widely held interests in investments organized as trusts demonstrate that there is no necessary element of the probate court, or family wealth transfer, or even of donative transfer, in order to be taxed as a trust. Thus, for example, a trust formed for the sole purpose of liquidating the assets of a corporation as
part of a Chapter 11 bankruptcy will be taxed as a trust, with the trustee required to file
tax returns and pay taxes on the net income. Holywell Corporation v. Smith, 503 U.S. 47
(1992). And unit investment trusts will be taxed as trusts, no matter how broadly held, as
long as the trust investments are fixed from the start and the trustee has no authority to
vary the investments (other than short-term cash investments) Rev. Rul. 89-124, 1989-2
C.B. 262; Rev. Rul. 90-63, 1990-2 C.B. 270; Royalty Participation Trust, Commonwealth
Trust Company, Trustee 20 T.C. 466 (1953). On the other hand, even if all of the
investors are the beneficiaries of a testamentary trust, if they associate themselves to
manage an office building owned by the trust, they will be taxed as an association (a

Civil law constructs serving functions analogous to trusts should be judged
against this template in analyzing their probable, and proper, United States income tax
treatment.

3. Hague Convention on the Law Applicable to Trusts on Their Recognition

The Hague Convention on the Law Applicable to Trusts and on Their
Recognition (“Hague Trusts Convention”) is a multilateral treaty aimed at ensuring the
international recognition of common law trusts and equivalent civil law instruments.
requires ratifying states to recognize trusts that originate in a jurisdiction, whether
common law or civil law, that allows creation of the relevant category of trusts, and
provides choice-of-law rules for issues involving trust administration and relations with
For example, having ratified the Convention, a state in general would have to recognize a
charitable trust originating in a civil law jurisdiction that rejects trusts in general but
accepts charitable trusts. However, a state would not have to recognize a charitable trust
emanating from a jurisdiction that, while allowing trusts in general, rejects charitable

Thus far, twelve nations have ratified the Convention: Australia, Canada
(with declarations and reservations, and with the exception of Quebec), China (for the
Hong Kong Special Administrative Region only, and with declarations), Italy,
Liechtenstein, Luxembourg (with reservation discussed below), Malta, Monaco, the
Netherlands, San Marino, Switzerland and the United Kingdom and territories (with
reservation and declaration). Monaco and Switzerland both ratified the Convention in
Cyprus, and France have signed the Convention, but have not ratified it. Id.
Non-contracting states can benefit from the Convention in states which have ratified it,
however, because as a default rule Convention duties are owed universally, not merely to
fellow contracting states. Hague Trusts Convention, ch. IV, art. 31, 23 I.L.M. at 1391.
Because of the increasing attention to the Convention in recent years in several European countries, and the perception in Italy that the Convention has been of great use to Italian financial institutions in allowing them to use trusts, some European countries have stated a renewed interest in adopting the convention. Luxembourg, which had originally signed the Convention years ago, in 1988, but not ratified it, adopted legislation, on July 27, 2003, to ratify the Convention, and the Convention took effect in Luxembourg from January 1, 2004. Luxembourg, The Law of 27 July 2003 Relating to Trusts and Fiduciary Contracts. In ratifying the Convention, Luxembourg chose not to adopt Article 16, Paragraph 2 of the Convention, thus specifically not allowing the laws of a state with a close connection with the trust, but not the state whose law is designated to govern the trust, to be applied to the trust. Article 16 does permit in all cases the laws of a forum state “which must be applied to international situations” to apply to a trust. Further, Luxembourg chose to have the Convention apply in Luxembourg to constructive and resulting trusts, that is, those created by a court.

Luxembourg simultaneously amended and restated its own internal law of trusts, the fiduciary contract, or fiducie. By the terms of Article 2 of the Convention, other countries ratifying the Convention must now recognize the Luxembourg fiducie as a trust, because it complies with the essential requisite that the property which the fiduciaire holds upon trust for the fiduciant is separate from the personal assets of the fiduciaire. Law of 27 July 2003, Art.6. The Luxembourg concept of trust is that of a contract between the fiduciant, the settlor, and the fiduciaire, the trustee, and while third party beneficiaries of a fiduciary contract may ask a court to enforce it, Law of 27 July 2003, Art. 7(6), they may not rely on the contract to give themselves a direct interest in the property. Law of 27 July 2003, Art. 7(2). Only lending institutions, investment businesses, investment companies, securitization companies, pension funds, mutual funds or other financial institutions may act as fiduciaires under the legislation. Law of 27 July 2003, Art. 4. See the discussion of the new legislation by Paul Matthews in *Fiducia and the Hague Trusts Convention: the New Luxembourg Law*, Butterworths, May 14, 2004.

Switzerland announced in late 2004 that it intended to adopt the Convention. Press Release of the Swiss Federal Department of Justice and Police, October 20, 2004. The press release notes the increasing portion of international asset management accounts which are held in trusts, and the desire of Swiss banks and trust companies to afford certainty to their customers that title to assets held as a trustee will be separate from assets belonging to the institution for its own account. Switzerland had announced that it intended to reserve adoption of Article 13 of the Convention, like Italy, thereby allowing Swiss residents to create trusts governed by the law of other jurisdictions which recognize trusts, and allowing certainty as to the ability to create and recognize a trust. Filippo Noseda, *Switzerland and the Hague Trust Convention: Where Are We?*, Trust Law International (“Noseda”) at 14. In the event, Switzerland ratified the Convention on April 26, 2007 with no reservations, and the Convention took effect on July 1, 2007.
Liechtenstein and San Marino both adopted the Convention without reservations, effective in 2006. Monaco, like Luxembourg, adopted the Convention (effective in 2008), reserving adoption of Article 16, Paragraph 2 (thus not allowing the laws of a state with a close connection to the trust, but not the state whose law is designated to govern the trust, to be applied), and Article 20 (thus allowing constructive and resulting trusts).

While Cyprus has not ratified the Convention, it does have an international trust law, the *International Trust Law* (1992), and enacted an amendment to that law in March of 2012 to specify that Cyprus would recognize international trusts, but that questions regarding their administration or validity would be determined under the law of Cyprus.

**A. Definition of a Trust under the Convention**

The Convention defines a trust in terms of its structure and its function—specifically, “the legal relationships created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.” Hague Trusts Convention, ch. I, arts. 2-4, 23 I.L.M. at 1389. After considerable debate, it was decided that for purposes of the Convention a “trust” should include both common law trusts and civil law trust constructs, as long as they met the criteria of Article 2 of the Convention: a) the trust assets constitute a separate fund and are not part of the trustee’s own estate; b) title to the assets stands in the name of the trustee or another person on his behalf; and c) the trustee has the power and duty to manage the assets with which he is entrusted in accordance with the terms of the trust, and is accountable for his acts. This language allows for agency relationships in which a trustee transfers nominal title to an agent in order to facilitate various transactions – for example, where “shares of an incorporated company [are] held and traded by the trustee through a broker in street name . . . .” Adair Dyer, *The Civil Law Trust*, 32 Vand. J. Transnat’l L. 989, 1002 (1999) (“Dyer”).

The trustee has the power and responsibility to administer the assets in accordance with the terms of the trust and general requirements of law. Id. Contrasts between the Convention’s conception of trusts and the common law definition include: (1) the treaty does not mention the common law distinction between equitable and legal ownership, and (2) the treaty does not require the beneficiary to have rights against the trustee. Marizio Lupoi Chapter 7, *Trusts in Italy*, in *Trusts, a Comparative Study*, edited by Simon Dix, Cambridge U. Press (2000) (“Lupoi(b)’’); *See The Hague Trusts Convention*, in *Principles of European Trust Law* 943 (D.J. Hayton, et al., eds., 1999) (“Hayton(a)’’). As a default rule, the treaty applies only to trusts created voluntarily and evidenced in writing, Hague Trusts Convention, ch. I, art. 3, 23 I.L.M. at 1389, in effect excluding trusts imposed by law without regard to the parties’ intentions. *See* David J. Hayton, *Law Relating to Trusts and Trustees* 945 (15th ed. 1995) (“Hayton(b)’’); Emmanuel Gaillard & Donald T. Trautman, *Trusts in Non-Trust Countries: Conflict of Laws and the Hague Convention on Trusts*, 35 Am. J. Comp. L. 307, 318 (1987)
However, states can elect to recognize trusts “created by judicial decisions,” Hague Trusts Convention, ch. IV, art. 20, 23 I.L.M. at 1391, and in general can recognize any trust regardless of whether the Convention requires such recognition, id., ch. III, art. 14, 23 I.L.M. at 1390. Thus a “trust” need not be a common law, English-style trust to be a “trust” for the Convention.

B. Protection of Domestic Law under the Convention

The Convention does not require non-trust jurisdictions to give effect to purely domestic trusts. Hague Trusts Convention, ch. I, art. 5, 23 I.L.M. at 1389; also see Introduction, in Hayton(a) at 9-10. Thus, by ratifying the Convention, Italy has not bound itself to recognize a trust created in Italy by an Italian. (But see discussion below on creation of trusts by Italians using English law.) The Convention covers only trusts domiciled in jurisdictions that allow the relevant category of trusts under domestic law. Hague Trusts Convention, ch. I., art. 5, 23 I.L.M. at 1389. The reference points for determining the origin of a trust include the location of the trust assets, the residence or place of business of the trustee, the purposes of the trust, and the choice-of-law clause, if any. Id., ch. II, art. 7, 23 I.L.M. at 1389-90. While the choice-of-law clause is determinative when the settlor selects a trust jurisdiction, id., ch. II, art. 6, 23 I.L.M. 1389, non-trust states can decline to recognize trusts created nominally under foreign law where “significant elements” of the trust are domestic in nature, id., ch. III, art. 13, 23 I.L.M. at 1390.

The Convention does require (subject to compatibility with “public policy,” Hague Trusts Convention, ch. IV, art. 18, 23 I.L.M. at 1391, and collateral domestic laws such as matrimonial law or laws for “the protection of minors and incapable parties,” id., ch. IV, art. 15, 23 I.L.M. at 1389, and “those provisions of the law of the forum which must be applied even to international situations, irrespective of rules of conflict of laws,” id., ch. IV, art. 15, 23 I.L.M. at 1389) the recognition by a state which is party to the Convention of trusts that are in substance connected primarily to a jurisdiction in which the relevant type of trust is valid. Hague Trusts Convention, ch. III, art. 11, 23 I.L.M. at 1390. Recognition for purposes of the Convention involves deferral to general, common law principles: “that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.” Hague Trusts Convention, ch. III, art. 11, 23 I.L.M. at 1389. The law of the particular state with which the trust is most closely associated controls on matters ranging from the validity of the trust itself, id., ch. II, art. 8, 23 I.L.M. at 1390, to the right to recover from the trustee misappropriated trust assets, id., ch. III, art. 11, 23 I.L.M. at 1390. The Convention does not, however, supersede domestic law on “preliminary issues” relating to the mechanisms, such as wills and succession, by which assets come to belong to the trust. Id., ch. I, art. 4, 23 I.L.M. at 1389. But see Gaillard at 331 (noting controversy over whether the Rule against Perpetuities, in general and for purposes of the Convention, is a “rule limiting gifts or a rule limiting the holding of property”). The Convention similarly does not set rules for the taxation of trusts. Id., ch. IV, art. 19, 23 I.L.M. at 1391.
C. Relation between the Convention and other International Treaties

While the Convention identifies the circumstances in which states must apply foreign trust law in dealing with trusts, it stops short of mandating mutual recognition or enforcement of judgments on particular disputes in the trust law area. See Hayton(b) at 946. In addition, the Convention does not define what constitutes valid jurisdiction, in the international context, to hear a trust-related case, although, as noted above, the Convention does give trustees the standing to sue, and ensures that they can be sued in their capacity as trustees. Hague Trusts Convention, ch. III, art. 11, 23 I.L.M. at 1389.


D. Governing Law Under the Convention for a Trust

One of the fundamental issues under the Convention is how to determine the applicable law if the Settlor did not indicate a choice of law. The Convention provides:

Article 7

1. Where no applicable law has been chosen, a Trust shall be governed by the law with which it is most closely connected.

2. In ascertaining the law with which a Trust is most closely connected, reference shall be made in particular to:

(a) the place of administration of the Trust designated by the Settlor;

(b) the situs of the assets of the Trust,
(c) the place of residence or business of the trustee;

(d) the objects of the Trust and places where they are to be fulfilled.

The recent case of His Beatitude The Armenian Patriarch of Jerusalem v. Sonsino, (2002) 5 ITEL R 125, ChD, concerned a trust made in 1961 by a British citizen (by birth an Iraqi), perhaps domiciled in India, but claiming residence in London, for her own life benefit, but following her death “for the education and advancement of Armenian children” throughout the world, as directed by the Armenian Patriarch of Jerusalem. The trust named a London bank as Trustee, but did not select the applicable law. In a lawsuit brought following the Settlor’s death in 1999, her heirs in intestacy claimed that the trust was invalid either because it was established under the laws of a jurisdiction (Jerusalem: Israel? Palestine? Jordan?) which did not recognize trusts, or, if the trust were a valid English trust, its ultimate charitable purposes failed to meet the strict tests of the Charities Commission as to charity in the United Kingdom. Interpreting Article 7 of the Convention and common law, the Court found the trust to be a valid trust governed by the laws of England.

E. Prospects for U.S. Ratification of the Convention

The U.S signed the Hague Trusts Convention in 1985, but has not yet ratified the Convention. In determining whether to recommend ratification, the State Department sought endorsement from organizations including the American Bar Association (ABA) and the American College of Trusts and Estates Counsel (ACTEC). Both the ABA and ACTEC provided such endorsements of the Convention and U.S. ratification. In the early 1990s, however, opposition to U.S. ratification arose, mainly in the State of Louisiana which feared that ratification of the Hague Trusts Convention would lead to problems in its domestic property law caused by interference of foreign trust law with domestic rights of inheritance and forced heirship. Although the Hague Trusts Convention requires neither the enforcement of specific foreign judgments nor the application of foreign trust law in purely domestic situations, concerns about intrusion on domestic trusts and estates law may underlie Louisiana’s continued reluctance to support the Convention. Similarly, apprehension appears to exist in some quarters that signing the Hague Trusts Convention could lead to U.S. ratification of the Convention on the Law Applicable to Succession to the Estates of Deceased Persons, a related international convention that could alter the U.S. law of succession, an area traditionally reserved to individual state control. See Convention on the Law Applicable to Succession to the Estates of Deceased Persons, 28 I.L.M. 150 (1989) (“Hague Succession Convention”).

4. Civil and Islamic Law Constructs Which Are Similar to Trusts

Without trying today to trace their evolution from the Roman fideicommis-sum or Germanic legal concepts, I would like to examine five constructs in use today in one or more civil law countries, as well as the trust construct under the Sharia, and explore how they share many characteristics of trusts, but not all. The civil law
constructs are the usufruct, the Stiftung, the Anstalt, the Treuhand and the fideicommissum. Those wishing to study the history of civil law constructs in greater detail might consult Trusts, A Comparative Study, edited by Simon Dix, Cambridge U. Press (2000).

A. Civil Law Constructs

(1) Usufruct

A usufruct is a right of use, a *usufructus*, a right to enjoy the fruits of a property for a term. Most commonly, a usufruct is a life estate in a surviving spouse, but it can be given or sold to another party, for life or for a term of years. We are all familiar with life estates in connection with the marital deduction under Section 2056 of the Internal Revenue Code, but a life estate is in most essentials similar to a life income interest in a simple trust. There just isn’t a trustee. In our legal system, the life tenant has responsibility to maintain the property from his own assets, since he enjoys the use and profits of the property during his lifetime. *In re Jaffer’s Estate*, 254 App. Div. 448, 5 N.Y.S. 2d 671 (New York Sup. Ct., App. Div. 1938). Courts have ordered some expenses to be paid from the property, analogizing those expenses to the expenses a trustee pays from trust principal. *Estate of Davis*, 100 Misc. 2d 498, 419 N.Y.S. 2d 827 (New York Surr. Ct., 1979). In a civil law system, the life tenant, the usufruttario in Italy today, may have the right of enjoyment without the same duty of maintenance New York would generally impose upon him.

As John Merryman has demonstrated, in Italy today an owner of land, A, can create an *usufrutto* in B for life, and then devise the residue of his estate to his son, C, but direct him to retain and conserve the property, and pass it on to his children when he dies. Merryman, at 934. This arrangement is in many ways similar to our life estate and remainder. But B has a *usufruct* which can’t be alienated and C has title, with ownership responsibilities, but perhaps (unless he survives B) no privileges.

There have been numerous cases reported (if in cryptic, abbreviated form) from Poland in recent years involving usufructs. It appears that the Polish government has resorted to the usufruct to resolve competing property claims between historic owners and post World War II, Soviet owners by giving the Soviet owner a usufruct.

A usufruct is a limited estate in property, a division of title, but it is not a trust.

(2) Stiftung

The Stiftung is a creature of statute, but it serves many of the functions of a trust. Stiftungs, or foundations, may be created under the laws of Switzerland and Liechtenstein. (Generally, see discussions in Chapter 17, on the law of Switzerland (written by Olivier Durrant and Carl Heggli, of Borel and Barbey) and Chapter 21, on the law of Liechtenstein (written by Peter Marxer, Jr. of Marxer and Partners (“Marxer”)) in

In Switzerland, a Stiftung must be for charitable purposes and is subject to control of public authorities (Articles 80 to 89 of the Swiss Civil Code). A family foundation, or *Familienstiftung*, may be created under a separate statute, art. 335 SCC, to pay the costs of education, succor and other assistance of the donor’s family. Family foundations cannot be created for general management of assets and payment of income to a family. Thus, at least in Switzerland, a Stiftung is an entity with a separate existence and management by an independent board, but it exists for charitable purposes. This is consistent with the general continental approach to allow the creation of charitable trusts, but not personal trusts.

In contrast to Switzerland, Liechtenstein allows the creation of Stiftungs for charitable or personal purposes. Under the Liechtenstein Persons and Companies Act of 1926 ("PCR"), as amended, a foundation can be created for any specific purpose. The assets devoted to the purpose are withdrawn from the founder’s separate property and are governed by an autonomous board. A Stiftung cannot conduct commercial activities. Foundations are subject to payment of an annual capital tax, but not an income tax. (Marxer, § 21.03[3], in Christensen).

Thus, the Liechtenstein Stiftung is in many ways similar to a trust, and as we shall see below, is one of the few foreign trust-like entities whose U.S. tax treatment has been examined by a U.S. Court.

Variants of Stiftungs also exist in Germany and Austria, again for charitable purposes.

(3) **Anstalt**

Anstalts, or establishments, don’t exist in Switzerland. They only exist in Liechtenstein. Again, the Anstalt is a creature of statute, with independent existence, registered in the public register. The settlor of the Anstalt retains so-called founder’s rights. An Anstalt has no shareholders, but it does have beneficiaries. The bearer of the founder’s rights has the supreme authority of the Anstalt, and may vary the terms of the by-laws (Marxer, §21.03 [2], in Christensen).

Thus, Anstalts share some characteristics with trusts. Indeed, because of the founder’s rights they share many characteristics with revocable trusts, and American lawyers using Anstalts as part of an offshore structure need to be careful of the possible estate tax consequences of doing so.

But because Anstalts may, unlike Stiftungs, conduct business, they are generally used as holding companies in conjunction with trusts, and not as a trust substitute.
Treuhand

A Treuhand is essentially a contractual relationship under Germanic law, recognized today in Germany, Austria and Switzerland, among other countries. It is a creature of case law, and not statute. By the Treuhand, or *mandat*, the settlor (Treugeber) transfers property to the fiduciary (Treuhänder), and gives him instructions on its management and for whose benefit he holds the property. Thus, in important ways a Treuhand resembles a trust and perhaps should be analyzed as a trust for U.S. income tax purposes. There are 3 parties — a settlor, a fiduciary, and one or more beneficiaries. The fiduciary administers the property subject to the settlor’s instructions, generally does not conduct a business, and distributes benefits to passive beneficiaries who are not associates. Because under German law the difference between legal and equitable title is not known, the Treuhand relationship is enforceable between the settlor and the trustee, at least in damages for breach of trust, but it is not enforceable *vis à vis* third parties, because to them the Treuhänder is the absolute owner. Pollzien, *Treuhand versus Trust in German*, Selected Papers of the International Academy of Estate and Trust Law, 1997-9, Atherton ed, Kluwer Law International, 2001 at 52.

The Treuhand suffers from significant weaknesses in comparison to trusts. First, it is a contract, enforced by the courts, but it must be entered into *inter vivos*, and thus is generally not used for estate planning. (See discussion in Chapter 18, on the law of Germany, written by Christian von Oertzen, of Flick, Gocke, Schaumburg, in Christensen, in particular § 18.06).

Second, the enforcement of Treuhands by the courts is sporadic, so that settlors cannot be fully confident the fiduciary will be required to fulfill their mandate. And third, in the event of the fiduciary’s insolvency, all of his assets, including the “trust” assets of the Treuhand, are subject to the claims of his creditors. A.E. Von Overbeck, *National Report for Switzerland*, in *Principles of European Trust Law*, Hayton, Kortmann and Verhagen, ed., Kluwer Law International (1999), at 109-110.

This general weakness of civil law constructs resembling trusts, that creditors of the manager, or fiduciary, may attach trust assets as if they were the manager’s own, has been broadly noted as a reason why civil law should assume at least some characteristics of common law trusts. Hansmann and Mattei, at 466.

Fideicommissum

The fideicommissum exists in Roman law countries such as Italy and France and Spain, and in Latin American countries which trace their law to the law of Spain, such as Chile. The fideicommissum has aspects of the trust, but only some of them. In France, there is no provision in the Civil Code for a *fiducie*, and so enforcement of fiduciary arrangements has been sporadic, but subject to the overriding principles of forced heirship and unitary property law, a French Court will try to enforce a fiduciary contract upon the fiduciary as a matter of agency law. The *fiducie* (or, as has been suggested, “crypto-fiducie”) will be required as a matter of contract to carry out his
obligations, whether managing tangible personal assets or widely held securities, but commentators suggest the law is inadequate in France to use the *fiducie*. France considered adopting a statutory category of *fiducie*, in 1992, but did not. Remy, *National Report for France*, in *Principles of European Trust Law*, Hayton, Kortmann and Verhagen, Eds., Kluwer Law International, 1999. Maurizio Lupoi traces the history of the Roman fideicommissum in his chapter in *Trusts: A Comparative Study* (Simon Dix, above), concluding that the fideicommissum as such is defunct, but that the principle of the fiduciary substitution, the *fiducia* whom, without express instructions, is to carry out the wishes of the settlor, remains. Lupoi describes the structure in Italy as “ethical more than legal”, but today “drag[ging] the *fiducia*, this view of fiducia, from the area of conscience and dropped it to the area of law.” See discussion in Hansmann and Mattei, at 443-5.

In Switzerland, it has been suggested, the *fiducie’s* responsibilities will be enforced by a Court, as a matter of contract, but (1) the remedy is in damages, with no tracing of property, and (2) there is no segregated property. Thorens, *The Trustee in a Civil Law Country: The Case in Switzerland*, Selected Papers of the International Academy of Estate and Trust Law, 1997-9, Atherton, ed., at 25.

In Colombia, since 1873 the Civil Code has provided for the “*propriedad fiduciaria*”, an entity similar to the fideicommissum. The right to act as the fiduciaria is limited to individuals (see below for new legislation applying to banks), and limited to a duration of no more than 30 years or the life of the fiduciaria. The income on the “trust” assets is taxable to the beneficiaries, whether or not distributed, if they can be determined, or to the fiduciaria if they cannot be determined. This structure is in most ways like our common law trust, and is a creation of civil code, not case law, but it has not been widely used. (See discussion in Chapter 22, on the laws of Colombia, written by Juan Manuel Prieto, of Prieto & Carrizosa, in Christensen) (“Prieto”).

In sum, the descendants of the fideicommissum seem in many ways analogous to 14th century trusts: the concept is known and recognized, but is not a creature of statute (a real weakness in a civil law country), except in Colombia, and is not enforceable at law. Thus the fideicommissum in many ways is a trustee, but his creditors can attach his “trust” assets, and his role is described by commentators as that of an agent, under contract, and not a trustee.

**B. Islamic Law Construct**

(1) **The Waqf**

The Islamic waqf (or “wakf”) has its origin in the religious law of Islam, called the sharia. See Jeffrey A. Schoenblum, *The Role of Legal Doctrine in the Decline of the Islamic Waqf: A Comparison with the Trust*, 32 VAND. J. TRANSNAT’L L. 1191, 1194 (1999) (“Schoenblum(a)”). Traditionally used “as a means of disposing property for what would be perceived in the common law as ‘charitable purposes,’” the waqf may also be used to provide for family members (known as a “waqf ahli,” or “waqf dhuuri”).
By tradition, the first waqf was created by the Prophet for the Mosque of Quba in Medina, and he also created a waqf from seven orchards in Medina for the relief of the poor. Paul Stibbard, David Russell and Blake Bromley, *Comparison of Trusts and Waqfs*, Papers of the International Academy of Estate and Trust Law, 21 May 2012, at 1.

Similar to a trust, a waqf entails a settlor (the “waqif”), a trustee (the “muttawalli”) and beneficiaries (the “mustahiqqun”). See Avisheh Avini, *The Origins of the Modern English Trust Revisited*, 70 Tul. L. Rev. 1139, 1157-59 (1996). Typically, a waqf is created upon the settlor’s declaration that “that the income of the subject property is to be permanently reserved for a specific purpose, at which point his ownership is ‘arrested’ or ‘detained.’” Id. at 1153. Although the declaration need not be in writing (which it usually is anyway), the settlor must clearly state his intentions, including that the property “must neither be sold nor given away nor bequeathed,” and must describe in detail the property, purpose and beneficiaries of the waqf. Id., quoting Heffening, in 8 Encyclopedia of Islam 1096 (1928). In his declaration, the settlor may exercise fairly broad discretion in dictating the terms of the waqf, including, for example, naming beneficiaries, appointing trustees (including himself) and determining the distribution of income. Under no circumstance, however, may the settlor name himself as a beneficiary, see id. at 1157-58, or retain the power to revoke the waqf. See Schoenblum(a), at 1218.

Unlike common law trusts, where legal title to the trust property is held by the trustee, title to waqf property vests in the Almighty. Trustees of waqfs, therefore, are more akin to custodians or superintendents, which, when compared to the role of trustees of trusts, greatly inhibits their ability to administer the property. See Schoenblum(a), at 1218-1219. The duties of a waqf trustee are dictated by the terms of the waqf, and usually include maintaining the waqf property, distributing income, paying beneficiaries and resolving disputes involving the waqf property. These duties are performed under the supervision of a judge (“qadi”) with jurisdiction over the waqf property. The judge may remove the trustee for cause (or without cause, if the trustee was appointed by him) and may appoint a trustee in the event that no trustee was named, nor criteria for appointing a trustee set, in the waqf. See Avini, at 1158. Finally, although a settlor may grant a trustee the power to name his successors, once appointed, a settlor cannot remove (or retain the power to remove) the waqf trustee. See Schoenblum(a), at 1221.

Beneficiaries are entitled to share in the waqf property as set forth by the terms of the waqf. Should a beneficiary fail to satisfy any condition expressly provided in the waqf, they may forfeit their interest. In circumstances where a beneficiary violated “an express and unambiguous condition of the waqf,” the trustee has been permitted to remove the beneficiary and replace him or her with another. See Avini, at 1158.

Despite their similarities, significant technical and historical differences between trusts and waqfs have led to the decline of the waqf as a system for managing
family wealth. Primarily, the waqf is for charitable purposes, not family purposes. Also, the religious foundation in Islam has forced the waqf to maintain its original rigidity for over a thousand years. Whereas, over time, the trust has been afforded the freedom to adapt to changing circumstances and the evolving needs of individuals managing their wealth, the waqf has remained virtually stagnant. See Schoenblum(a), at 1198-1201. For instance, waqfs may only be created by Muslims and for Muslim charitable purposes. Thus, some jurisdictions have invalidated waqfs because the founder adopted a new religion or because the waqf was for the benefit of “the poor,” a term interpreted to include non-Muslims. Id. at 1225. In addition, since inheritance laws are also governed by Islamic Law and waqfs can be used as a means of avoiding Islamic inheritance laws, few people in actuality use waqfs because they would rather honor Islamic traditions. See id. at 1201-04; see also Chaudhry, at 527-536 (discussing Islamic inheritance laws). In fact, legislation regarding waqfs has been largely geared toward preserving the traditional administration of waqfs (in some instances even outlawing family waqfs), rather than liberalizing their use. This conservative movement in Islam is in stark contrast to Anglo-American traditions founded on theories of individuality and “relatively unregulated private property ownership.” Id. at 1201-04.

In addition to the fundamental and historical differences just mentioned, the necessity of the charitable interest has limited broad use of the waqf, and even waqfs for families have little flexibility. While family members may benefit from a waqf, if there is no real charitable purpose the waqf will be declared void. In Abu Fata v. Russomay, Privy Council 15 December 1894 (1894) LR171A 28PC, the Privy Council declared void an Indian waqf created by two Sunni Muslims for their family because charity only took an interest if both families died out. And if charity is given a real interest, the interest of the family may be too inconsequential to invoke any interest. Accordingly, the beneficiaries end up with little or no motivation to maximize the productivity of the property or enforce their rights against the trustee. See Schoenblum(a), at 1206-1212. Another technical aspect of waqfs is their inalienability. With few exceptions (e.g., where the property has become so useless as to defeat the object of the waqf), waqf property may not be sold or exchanged. Even where a sale is permitted, the proceeds must be used to reinvest in other property. A sale or exchange is permitted, however, if the settlor authorized the sale or exchange at the waqf’s creation. Property held in waqf cannot, generally, be mortgaged, and any lease on such property may not exceed one year. See id. at 1212-1217.

Thus, despite many apparent similarities to trusts, the waqf has over time become a less efficient means of managing family wealth, but it remains robust in much of the world as a means of administering property for charity in perpetuity. In their May 21, 2012 paper for the International Academy, Stibbard, Russell and Bromley draw our attention to Monica Gaudiosi’s article, The Influence of the Islamic Law of Waqf on the Development of the Trust in England: The Case of Merton College, 136 U. of Penn. Law Rev. 1231 (1988), in which she analyzed the deeds creating Merton College, Oxford, under the Will of Walter de Merton, in 1274, and concludes that Merton, who had been Lord Chancellor, was influenced by the law of waqf in creating his perpetual charitable
trust. Throughout the Middle East today, the waqf is again in the ascendant, but for charity.

5. Civil Law Countries Recognizing Domestic Trusts

Beyond the constructs in civil law countries which attempt, with varying success, to serve the functions of a trust, at least three civil law countries, Colombia, Liechtenstein, and Italy, now recognize and enforce trusts as a matter of internal statutory law.

A. Colombia

Building upon its earlier, inadequate experience with the propriedad fiduciaria, Colombia in 1923 established as a principle of Colombian banking law that a Colombia banking institution could act as a testamentary trustee. However, again through lack of complete understanding, the institution was not widely used. In 1971 the new Colombian Commercial Code expanded and clarified the rules. The trusteeship is limited to 20 years except in case of trusts for charity or incapacitated persons, but the concept is that of a trust, with the bank holding title as fiduciary. Colombian Civil Code, Law 45 of 1990, Law 35 of 1993. Prieto, § 22.08 [1].

Thus, at least in Colombia, the trust exists as a matter of statute, is for the management of property, not the conduct of a business, and every effort has been made by the legislature, with expert consultants from the United States, to conform to the concept of trust in the United States. The law is not yet fully developed on challenges to title of the trust in the case of creditors’ claims, because under the statute only banking institutions can act as trustees. Individuals when they act are acting under the earlier, propriedad fiduciaria, legislation.

Quite recently, in 2011, Colombia amended the Código País to make trusts the presumptive vehicle to hold contract down payments for public contracts in safekeeping.

B. Liechtenstein

Liechtenstein has recognized and enforced trusts as a matter of internal, domestic law, since 1928. As in any civil law country, this is based on statute. There are two different types of trusts provided for in the legislation, the trust or Treuhänderschaft, and the trust enterprise, or Treuunternehmen. The latter is a Massachusetts business trust, expressly modeled on the Massachusetts law, which is to be operated as an autonomous business enterprise by the trustee. Art. 932a of the Persons and Companies Act. Such entities within our framework in the United States are business trusts, taxable as associations.
The Treuhänderschaft could be either a trust, or an association, under our rules. For the most part, persons creating what we think of as trusts in Liechtenstein create Stiftungs, not trusts. But an individual could decide to create a statutory trust, or Treuhänderschaft, which was created to hold, manage and invest assets, not to conduct a business. The statute provides for a wide variety of trusts. Art. 897 of the Persons and Companies Act. There is no rule against perpetuities, and the trust may have perpetual existence.

C. Italy

Italy is by far the most interesting country, analytically, in how it came to recognize trusts for purposes of internal law. Italy is, of course, a civil law country, and as such did not recognize trusts. But Italy was the first major civil law country to ratify the Hague Trusts Convention (in 1990, effective January 1, 1992), and since that time its lawyers and bankers have been studying the consequences of Italy’s having ratified the Convention. This study has been undertaken with enthusiasm, because Italy’s lawyers see real benefits to their commercial law from a recognition of trusts.

In his article on the recognition of common law trusts in civil law jurisdictions, Mauricio Lupoi speaks of “Hague Convention Trusts.” Lupoi(a) at 980. Lupoi points out that the definition of “trust” in Article 2 of the Convention is very broad (see discussion above; this was intentional on the part of the drafters) and will by its nature include many civil laws constructs analogous to trusts. Lupoi then points out that a settlor resident in Italy who wishes to create a trust may do so under the law of England, or another jurisdiction which does recognize trusts, as long as he declares the trust to be governed by the law of England. Convention, Article 6. The Convention allows Italy to decline to recognize the trust, if the only ties to England are the choice of law, place of administration of the trust, and residence of the Trustee, if the other elements of connection of the trust, such as residence of the settlor, location of the trust assets, and residence of the beneficiary, are all Italy. Convention, Article 13. But, Lupoi points out, Article 13 of the Convention is optional: a State “shall not be bound” to recognize such a trust. In default of the State’s electing not to recognize such trusts, which Lupoi terms “trusts interni”, or domestic trusts, they will be recognized by reason of the State’s adoption of the Hague Convention. Italy in ratifying the Convention did not specifically exclude recognition of “trusts interni” by reserving recognition of Article 13.

Since ratifying the Convention, Italy has studied trusts more intensely than has any other civil law country. Many articles have been published, a series of conferences has been held under the auspices of the Italian Bankers Association, and standard trust forms have been developed for use by banks. The Italian Legislature has considered laws which contemplate the creation of trust – for the management of trusts generally, and for minors – which have not been passed. But the trusts so contemplated would have been trusts created under foreign law, because Italy still does not as a matter
of statute recognize trusts under its own laws. At least two cases have been decided, and both recognized a trust under the Hague Convention.

In the first case, decided by the Milan Commercial Court (the *Tribunale Civile e Penale di Milano*) on December 27, 1996, the court decided that a debenture agreement creating a trust governed by the law of Jersey should be enforced for the benefit of the debenture holders, even though the debentures were issued by an Italian company, Cofintec SpA, which transferred to the Trustee, Brera Fiduciaria, an Italian Company, all of its shares of Cofintec Real Estate Limited, an English company, which owned real property in Italy. The trust was created as security for the debentures, which were admittedly Italian property and were not part of the trust. The case is discussed in a Note by Paul Matthews in Trust Law International, Vol. 11, No. 1, 1997, at page 20. This decision was seen as indicative of the direction of the Italian internal law of trusts.

The second case, *Casani v. Mattei*, Foro it. 1998, 2007, 3391, interpreted a testamentary trust of land, created under a will executed in Kentucky by a dual national. The decedent’s daughter challenged the testamentary trust on the basis that the trust was an improper “fideicomissary substitution.” The court recognized the trust as a “common law trust” holding that Italy’s adoption of the Hague Convention compelled it to recognize the trust, noting that nothing in the Hague Convention bars the use of a trust by civil law nationals. While the Hague Convention does not enable the decedent to bypass forced heirship, the court held that the trust was valid and its terms would be unenforceable only to the extent required to eliminate any violation of forced heirship. For a discussion of *Casani v. Mattei*, see Lupoi(a) at 983-84; Jeffrey A. Schoenblum, *Multistate and Multinational Estate Planning* at 18-74 (3rd ed. 2006).

In his remarks in May of 2010 to the International Academy of Estate and Trust Law, Dr. Lupoi said that he thought there were thousands of trusts now in existence in Italy which were “trust interni”, and that the number was growing every month. Thus through a convoluted and quite intentional process, based upon a view that trusts as very useful creatures of commercial law, Italy is in the process of creating an internal law of trusts by reference to the Hague Convention.

Effective January 1, 2007, Italy for the first time enacted legislation regulating the income taxation of trusts. Law N. 296 of 27 December 2006. Under the new rules, if a trust has identified beneficiaries with identifiable interests in the trust income, the income will be taxed directly to the beneficiaries, and the trust treated as transparent. If there are not identifiable interests, the income will be taxed to the trust under Italian corporate tax rules. If the trust is established offshore, but not in a “white list” jurisdiction, the trust will be taxed as an Italian resident corporation. International Trust Planning with Italy, Boschini International Law Offices, 2007.
6. Recognition of Common Law Trusts by Civil Law Countries

Apart from the imaginative efforts of the Italian Courts to use the Hague Convention for the purpose of recognizing trusts interni, many civil law courts have been called upon to recognize common law trusts over time, and have made every effort to do so. The Hague Convention gives the Courts additional grounds to do so.

A. Switzerland

Perhaps the best known case over time has been Harrison v. Credit Suisse, BGE 96 II 79 (1970), in which an American national created a trust for the benefit of his about to be former wife and their children at the time of his divorce in 1928. Credit Suisse was the Trustee and the place of administration was Zurich. When Mr. Harrison died many years later, his second wife, named as his Executrix, and residuary legatee, tried to annul the trust and reclaim the assets, on the basis that the “trust” violated the law of Switzerland, the chosen law of the settlor. The Federal Supreme Court of Switzerland upheld the arrangement, although it found that it was controlled by Swiss law and was not a trust as such. The Court essentially enforced the “trust” as a contract, combining elements of a fiduciary transfer, a promise to make a gift, and a contract for a third party benefit. The Court said that the arrangement did not violate Swiss public policy, and that given the decedent’s residence in the United States, the laws of inheritance of the United States should be taken into account. This case of course antedates the Hague Convention, and Switzerland’s 2007 ratification of the Convention.

While the Harrison case has had the most publicity over the years outside of Switzerland, there have been other cases as well, in which the Swiss courts consistently tried to recognize and enforce trusts as a matter of contract. Noseda, pages 11 to 13. In the case of Werner K. Rey, ZR 98 (1999) 52, the Zurich appeals court was presented with a claim of OD-Bank in liquidation to recover its debt owed by companies owned by a Guernsey trust established by Mr. Rey. The defense was that Mr. Rey controlled both the trust and OD-Bank, and that OD-Bank was therefore not an independent entity entitled to enforce the debt. The Court held that Guernsey law applied, that under that law the trust was to be recognized as a separate entity, and that to the extent of its assets the debt obligation could be enforced by the OD-Bank trustee in bankruptcy.

In a 2011 decision in Switzerland, the Swiss Federal Administrative Tribunal (SFAT) was asked to characterize the rights of two U.S. citizen discretionary beneficiaries of an irrevocable trust created in the British Virgin Islands by deceased settlors with Union Bank of Switzerland as Trustee. The issue was whether information on the account had to be given to the Internal Revenue Service under the 2009/2010 agreement between Union Bank of Switzerland and the United States for financial disclosure concerning 4,500 accounts “owned” by U.S. persons. The SFAT held that disclosure in this case, which had been opposed by the two U.S. beneficiaries, was not
proper because they were discretionary beneficiaries of the trust, no distributions had been made to them from the trust, and they therefore did not “own” the account.

B. **Luxembourg**

In two decisions by the Luxembourg Court of Appeals, dated April 27, 1994 and May 22, 1996, trustees of Jersey trusts sued banks in Luxembourg with whom trust assets were deposited, seeking restitution of trust assets (or, alternatively, damages), because the banks had entered into transactions upon the instructions of the settlors of the trusts, whom the banks treated as the owners of the assets. The banks had copies of the trust deeds and had opened the accounts in the names of the trustees. The banks denied liability on the ground that trusts are unknown in Luxembourg, that Luxembourg does not recognize the separation of legal and equitable title, and that therefore they were entitled to rely upon the instructions of the settlors. The Court found for the trustee, based upon an extensive analysis of Jersey law, and held the banks liable for their actions. These are rather extraordinary cases because Luxembourg had signed the Hague Trust Convention at the time the cases were decided, but it did not ratify the Convention until 2003. The Court nevertheless used the Convention as the basis for an analysis of the trusts, and descriptive of good public policy of recognizing and giving validity to trusts created properly under foreign law. See the discussion by Schmitt and Thoma in *Trusts: A Few Reflections on the Luxembourg Experience*, in *Disputes Involving Trusts*, Vogt ed., at 371.

C. **France**

Many commentators have long held out France as the civil law country least likely to recognize and enforce trusts, and certainly trusts cannot own real estate and other tangible assets in France. But 2004 brought the first important French tax case dealing with trusts in many years, and as a result drew more attention to the status of trusts in France. In Poillot v. Director of Tax Services of the Hauts de Seine Nord, TGI Nanterre 4th May 2004, the issue before the Tribunal de Grande Instance de Nanterre was whether Madame Poillot was subject to French wealth tax on the principal of two trusts of which she was the income beneficiary. The trusts were Massachusetts trusts, established by Madame Poillot’s aunt and uncle, respectively, from which she had been receiving the income, which Madame Poillot was reporting for French income tax purposes. The French tax authorities took the position that she had an ownership interest in the trust principal by reason of her income interest. They capitalized her income interest at a 3% discount rate, and sought to apply the wealth tax to the capital value so derived.

The French wealth tax is an annual tax which, for French residents, applies to their worldwide assets. French Civil Code Article 885 A 1° CGI. Hence, if Madame Poillot’s income interests in the two Massachusetts trusts were deemed vested proprietary interests, she might have been subject to wealth tax, at graduated rates up to 1.8% a year, on the capital value as computed. The wealth tax does apply on such a basis to the
outright holder of a life estate (usufruct), subject to limited exceptions. Jean-Marc Tirard, *Trusts and French Wealth Tax*, The Journal of International Trust and Corporate Planning. The Poillot case, while not a decision of the highest French civil court, the Court de Cassation, does recognize the existence of trusts created outside of France as the true owners of property, at least for French wealth tax purposes. In his article, Jean-Marc Tirard suggests that the French courts have always been willing to recognize trusts created outside of France by nonresidents of France. In another article, in the Rothschild Trust Review for Spring 2005 (Issue 11), Jean-Marc Tirard cites several earlier decisions of French courts, which recognize trusts as contracts, enforceable by the settlor, but do not allow French residents to place their own property in trusts.

In *Department of Tax Services of Finistère v. Tardieu de Maleissye Consorts*, Court of Appeals of Rennes 4th May 2005, the issue before the court was whether the assets of a trust should be treated as indirect gifts to the French resident beneficiaries, meaning that French gift tax would be due upon termination of the trust. The trusts were U.S. trusts, established by Monsieur Tardieu de Maleissye, who received income from the trust for his life. The remainder of the trust was left to his descendants, or, in default of such descendants, to those persons designated in his will. In evaluating the gift tax consequences, the Court of Appeals of Rennes recognized the trust structure, and it concluded that by the provisions of the trust, an indirect gift was made by Monsieur Tardieu de Maleissye to his daughters as of his date of death.

On July 29, 2011, the French National Assembly passed an Amended Finance Bill which effects many changes in the income, wealth and inheritance tax imposed on individuals. France still does not recognize purely domestic trusts, but does understand trusts and is trying to sort out the taxation of foreign trusts. With respect to trusts, the law creates a special tax regime for foreign trusts and foundations. If the settlor, or a beneficiary or trust assets are located in France, the trustee must disclose the existence of the trust to the French tax authorities (note that as of July 1, 2012, a decree from the French tax authorities detailing these reporting obligations is still forthcoming). From and after January 1, 2012, a wealth tax at the annual rate of .5% applies to all assets of a foreign trust which has French beneficiaries if the assets are not being reported by the beneficiaries. No gift tax will be imposed when a French settlor creates a foreign trust, but the assets will be subject to inheritance tax on his death. Thus, while still not “recognizing” trusts domestically, as a matter of internal law, or through recognition of the Hague Convention, the French tax authorities clearly recognize trusts for what they are and seek to tax them.

France has signed Tax Information Exchange Agreements since 2009 with 35 foreign jurisdictions, including Andorra, Anguilla, Antigua and Barbuda, Aruba, the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, the Cook Islands, Grenada, Guernsey, Jersey, Liechtenstein, and the Turks and Caicos. The agreements seek disclosure of tax information on offshore accounts established by French residents, including trust accounts.
D. Spain

On May 14, 2010, the Directorate General of Taxation of Spain published a binding ruling on the income, inheritance and estate tax treatment of assets placed in an English law trust in Gibraltar by a nonresident alien of Spain. To the extent relevant in Spain, because of Spanish source income or ultimate Spanish resident beneficiaries of the trust, the Directorate General ruled that for Spanish tax purposes:

1) Spain does not recognize trusts and all income of the trust, no matter the extent of the settlor’s retained interest in the trust, will be taxed to the settlor while he is alive; and

2) Upon the death of the settlor, Spanish inheritance tax will apply, to the extent it may apply, to the transfer of any assets in the trust.

Spain has not adopted the Hague Trusts Convention.

E. Italy

Finally, Italy in 2010 published Circular 61/E covering the taxation of fiscally ineffective trusts, which are taxed as grantor trusts fully taxable to the settlor. The Circular gives guidance that revocable trusts, trusts which include the settlor as a beneficiary, trusts where the settlor can add or vary the beneficiaries, trusts for which the settlor can control all decisions of the trustees, and trusts when the settlor can borrow the trust assets or repurchase them, are all to be treated as fiscally ineffective and taxed to the settlor. These are remarkably similar to the U.S. grantor trust rules.

Prior to Circular 61/E, Italy has generally recognized trusts which are not fiscally ineffective, and either taxed the income to the beneficiaries, at individual rates, if the interests of the beneficiary are clear and ascertainable, or taxed the income to the trust, at corporate rates, if the interests of the beneficiary are not clear.

Other commentators have in recent years focused on so-called “mixed jurisdictions”, such as Scotland, Quebec and South Africa, which have a combination of common law and civil law. Reid, First Worldwide Congress on Mixed Jurisdiction: Salience and Unity in the Mixed Jurisdiction Experience, 78 Tulane Law Review 5 (2003). Reid suggests that most of these jurisdictions-- Scotland, Louisiana, Quebec--adopted trusts in the first instance by case law, in the common law experience, but legislation generally followed, in the civil law tradition, recognizing and regularizing trusts in each jurisdiction.

This “mixed law” history for trusts has also been the experience in The Republic of South Africa. South Africa, in modern times, had a Roman Dutch law heritage, and trusts began their history from 1806, when the Cape became an English colony. Since then, trusts have been recognized in South Africa, but only to an incomplete extent, because South Africa, in keeping with its Dutch background, does not
recognize equitable ownership in trust beneficiaries. There is unitary ownership of the trust assets in the trustee, and the beneficiaries may only enforce monetary judgments against the trustee, and not judgments in rem against the trust assets. (Andrew Vergunst, the laws of South Africa, Chapter 24 in Christensen, § 24.11) South Africa does tax trusts as separate entities for income tax purposes, and will tax the trust income to the settlor, or the trustee, or the beneficiary, according to the facts of the case (that is, whether the settlor has retained interests in the trust, or whether, if the settlor has not done so, the trust income is retained by the trustee, or distributed to a beneficiary).

Many commentators suggest that the courts of civil law countries will make every effort to uphold a trust, as long as its assets do not include realty located in the civil law country, and perhaps subject to claims of heirs under forced heirship. However, the difficulty of unpredictability in results has led many to urge adoption of the Hague Convention, not for the purpose of requiring a civil law jurisdiction to recognize trusts created by its residents (but witness Italy), rather to give additional strength to the well intentioned courts that are trying to enforce the title of a trustee to assets clearly belonging to the trustee in the jurisdiction where the trustee is administering the trust, so that the trustee can enforce his rights in the courts of the civil law jurisdiction.


There are remarkably few cases and rulings in the United States characterizing the various civil law constructs for U.S. income tax purposes.

The provisions of Treasury Regulations § 301.7701-4, discussed in Part 2, above, are intended to apply to all similar types of organizations, however called, and however characterized under the laws of their own jurisdiction. The point is that United States Federal tax law governs the characterization of an entity for United States Federal income tax purposes, applying common principles to all entities to achieve (hopefully) consistent tax treatment, no matter what the entity may be called under local law. In Private Letter Ruling 200508004 (issued on November 10, 2004; released on February 25, 2005), the Service was asked to classify an “entity” organized under foreign law for United States Federal income tax purposes. The PLR notes that “X”, the entity organized under the laws of Country A, was organized as a separate entity to provide disability, old age and/or death benefits to retired employees and their spouses. X has a pool of assets, contributed by the employer and the employees, which its governing board invests under supervision of a government agency. Citing the provisions of Treasury Regulations § 301.7701-4(a) that “trusts” are arrangements under which trustees take title to property for the purpose of managing and investing it for the benefit of beneficiaries who are not “associates” in the venture, the Service rules in this PLR that the entity in question is a trust, while noting that “if an entity has both associates and a business purpose, it cannot be classified as a trust for federal income tax purposes.”
Perhaps the best known case, *Estate of O.T. Swan*, 247 F. 2d 1957 (2d Cir. 1957), involved two Stiftungs, in Liechtenstein and Switzerland. Mr. Swan, a Chinese national resident in the Netherlands, created the Stiftungs at the beginning of the Second World War. Mr. Swan opened accounts with Guaranty Trust Company and New York Trust Company in New York City. The Stiftungs, properly organized under charters and by-laws, were for the benefit of Mr. Swan and his family. Mr. Swan died in 1943. The case is an estate tax case, not an income tax case, because Mr. Swan’s executors claimed that the two Stiftungs should be treated as corporations, not trusts, and that therefore the assets of the Stiftungs should not be subjected to U.S. estate tax, because they were the assets of a foreign corporation, and so not taxable for U.S. estate tax purposes under the predecessor of Section 2104(a) of the Internal Revenue Code. The Internal Revenue Service claimed that the Stiftungs were in fact operated for Mr. Swan’s benefit during his lifetime, and so should be treated as revocable trusts. The Tax Court held that they were trusts. The Court of Appeals held that they didn’t have to be characterized, as trusts or corporations, because they were revocable and so the assets were taxable in Mr. Swan’s estate under the predecessor to Section 2104(b) of the Code. Thus this case, widely cited as it is, doesn’t take us very far. Because the taxpayer had not followed all statutory requirements, and had acted as if the Stiftungs were his own property, the Court of Appeals ignored their existence. But the case remains authority for the proposition that a Stiftung can be a trust or a corporation, depending upon the facts of the individual case.

*Estate of O.T. Swan* has remained an important precedent whose principles continue to be relied upon. Recently the laws of the Netherlands Antilles with respect to “private” (i.e., non-charitable) foundations have been revised with close attention to the principles of *O.T. Swan*, so as to set out standards under which a foundation would have independent legal existence. This status may, dependent upon applicable law, be very important. It is a truism of common law that a trust does not exist as a separate legal entity (the trustee owns the assets in a separate capacity, not the trust as such), but a foundation may be a separate entity.

More recently, in Private Letter Ruling 200302005, the Internal Revenue Service cited *O.T. Swan* in determining the tax treatment of a Stiftung. Taxpayer was a resident alien of the United States who sought a prospective ruling as to the estate tax treatment under Section 2055 of the Code of the proposed bequest of his residuary estate to a foreign Stiftung. With a full analysis, the Service ruled that the Stiftung was in the nature of a trust, and that as long as the proposed Stiftung was to be irrevocable and fully charitable, the bequest of taxpayer’s residuary estate would be deductible under Section 2055 of the Code, even though the Stiftung did not intend to seek a determination of exempt status under Section 501 of the Code. The Service found that the Stiftung would be described in Section 4947(a)(1) of the Code, as a charitable trust, and thereby meet the requirements of Section 508(e) of the Code.

*O.T. Swan* was also cited in Advice Memorandum 2009-012, in which the Internal Revenue Service examined the entity classification for tax purposes of Liechtenstein Anstalts and Stiftungs. The Service concluded that Liechtenstein Anstalts
are usually classified as business entities under Treas. Reg. § 301.7701-2(a) rather than as trusts under Treas. Reg. § 301.7701-4(a) because their primary purpose generally is to actively carry on business activities. If, however, the facts and circumstances of a particular case show that an Anstalt was created to protect or conserve the property therein for the benefit of beneficiaries, the proper classification for an Anstalt may be as a trust.

The Service further found that the proper classification for a Liechtenstein Stiftung is generally as a trust under Treas. Reg. § 301.7701-4(a), because the primary purpose of a Stiftung most often is to protect or conserve the property therein for the beneficiaries of the Stiftung. If, however, a particular Stiftung was established primarily for commercial purposes, it may be classified as a business entity under Treas. Reg. § 301.7701-2(a).

In Commissioner v. Nevius, 76 F.2d 109 (2d Cir. 1935), also an estate tax case, the Court of Appeals held that a trust was a trust, and as such was not a corporation. Mrs. Nevius held a one-eighth interest in a testamentary trust created by her husband in England, and on her death exercised her general power of appointment over that share of the assets of the trust. Mrs. Nevius’ executors tried to avoid taxation of the trust assets in the United States, upon the basis that she held an interest in a foreign entity and so didn’t hold an interest in U.S. assets. The Court of Appeals held that an interest in a trust is a conduit interest in the assets themselves, and therefore Mrs. Nevius’ one-eighth interest in her husband’s trust was subject to estate tax here. So in this case a trust was recognized as something other than a corporation. But this was a real trust, an English trust. And Mrs. Nevius’ general power of appointment should have been enough to result in a U.S. estate tax, unless the trust were treated as the equivalent of a foreign corporation.

In Revenue Ruling 79-116, 1979-1 C.B. 213, the Internal Revenue Service characterized an Anstalt. The ruling is for purposes of characterizing a foreign corporation as a foreign personal holding company under Section 552 of the Internal Revenue Code. S, a foreign corporation, was in the business of investing in U.S. securities for its own account. S was wholly owned by P, an Anstalt, which had been created by A, a nonresident alien, who retained the founder’s rights. A was married to B, a United States citizen. Without explanation, the ruling holds P, the Anstalt, to be a revocable trust, and thus determines that S, the corporation, is a foreign personal holding company, because all of its stock is owned by A and attributable to B, A’s wife. Because A is a nonresident alien, in fact none of the income was taxable in the United States. The ruling, for our purposes, would have been more helpful had it included reasoning, but the founder’s rights were enough, it appears, to treat the Anstalt as a revocable trust. If the settlor had assigned the founder’s rights, would the Anstalt have been taxed as a trust, or as a corporation?

In Revenue Ruling 80-75, 1980-1 C.B. 315, the Internal Revenue Service characterized a trust which was a trust under local law, but which the IRS found to be an
association taxable as a corporation. Here investors had pooled money with a promoter, who bought patent rights from an inventor to exploit. We don’t know if the local law was domestic or foreign, but the ruling holds that where there are associates who are together in business, it is an association, not a trust, no matter what local law may say.

Where should these few pronouncements take us? There is nothing in the Internal Revenue Code that says a trust must be called a trust in order to be taxed as a trust. Indeed, the Regulations say that “local law” is not to be determinative, and that the issue is solely one of analyzing the characteristics of the arrangement, in particular whether there are associates and whether there is an objective to carry on business and divide the gains therefrom. So, it would seem, the civil law constructs we have examined should be taxed under Treas. Reg. § 301.7701-4 in accordance with their characteristics.

**How Shall One Tax the Civil Law Constructs?**

I would suggest that a usufruct should be taxed to the income beneficiary, directly. This is “mere co-ownership” of property, and so taxed directly to the owners under Treas. Regs. § 301.7701-(a)(2).

A Stiftung, I would suggest, is much more a trust than it is a corporation. *Swan* stands for that principle, but wasn’t necessary to the Court’s holding. The point, however, is that a Stiftung is a donative arrangement to manage property, not to conduct a business, which has no associates. PLR 200302005 is strongly affirmative of the trust analysis of a Stiftung, although, again, as the issue here was the charitable deduction under Section 2055, and as the deduction would be available to a foreign charity organized either as a trust or as a corporation, the analysis in the PLR may be regarded as unneeded.

An Anstalt has been ruled to be a revocable trust by the Internal Revenue Service, but in other circumstances might be found to be a corporation, if the founder assigns his founder’s rights to another.

A Treuhand hasn’t been characterized by a Court or the Internal Revenue Service for U.S. income tax purposes, nor has a fidecommissum, but they share many characteristics. They could be found to be trusts. Or they could be found to be contractual arrangements whereby the Treuhänder, or the fiducie, is the real owner, and liable for income tax, but owes the property to the beneficiary, or, alternatively, whereby the beneficiary is the owner, and the Treuhänder is an agent. Here is another place where the Hague Convention might in time be of help for characterization purposes, and for the proliferation of “trusts interni”.

A waqf is probably a charitable trust, and need not obtain a ruling from the Internal Revenue Service to qualify as such, but its use is often broader than a clear and limited charitable trust under U.S. law. However, where family members may also benefit, it perhaps should be treated as a Stiftung.
I’m sure we will be reading more about this subject, as the Internal Revenue Service is called upon to characterize more civil law entities in the years to come.