



THE 11TH EDITION OF THE INTERNATIONAL CONFERENCE
**EUROPEAN INTEGRATION
REALITIES AND PERSPECTIVES**

**Trust Regulation in the Czech Republic: the Model Law for Introduction of
the Trust Instrument in the Republic of Latvia?**

Janis Grasis¹

Abstract: In the last decades, thanks to the process of globalization, there is the diversification of forms and kinds of the economic relations. Therefore the trust instrument is used more and more in the countries where before it was practically unknown legal instrument. The author has defended dissertation paper “The Essence of Trusts, its Recognition and Legal Regulation in the Roman – German Law System Countries and Possible Introduction in Latvia” on September 12, 2008. In this dissertation paper it was advised to introduce trust instrument in the Republic of Latvia in order to improve the existing regulation in Latvia; draft law on trusts was prepared. The Czech Republic had introduced trust instrument from January 1 2014. This article will be devoted to the comparative analysis of the Czech regulation on trusts; therefore it is a very important both from academic and practical point of view. Till now there are a few researches on this theme. The survey and comparative analysis are the main methods used in the present article. Based on the comparative analysis it is recommended to use regulation of the Czech Republic and Province of Quebec in order to draft similar legislation in the Republic of Latvia. The present research is a very topical for the academics, Members of the Saeima (Latvian Parliament), practitioners in the financial and legal field. This is unique research on comparative basis, using Civil Code of the Czech Republic and Province of Quebec, the Principles of European Trust Law, the Hague Convention on the Law Applicable to Trusts and on their Recognition and existing regulation and prepared draft legislation on trusts of the Republic of Latvia.

Keywords: trust; Civil Code of Quebec, Civil Code of Czech Republic; Hague convention; Principles of European Trust Law.

Introduction

The trust is one of the most popular legal institutions for wealth management in Common law jurisdictions. In recent decades and years there has been a significant burgeoning of interest in the reception of the trust in civil law jurisdictions, which have fuelled enthusiasm in the comparative study of trusts around the world (Lupoi, 2000; Hayton, 2010). The trust law is a legal mechanism by which English law recognizes and enforces a separation between the legal ownership of property and the right to enjoy the benefits of that property. When a trust has been created, the trustee holds legal title to the property, but the beneficial entitlement to the property rests in the hands of the trust beneficiaries (Cane & Conaghan, 2008). Probably the declaration by the M.S. Amos that “English trust are spread throughout like eggs of the Cuckoo in the Continental law countries” (Amos, 1937) is exaggerated, however this expression has a truth. Also in the law systems, which is not based on the English common law and equity, there are law instruments by its essence similar to the Common law trust.

¹Associated Professor, PhD, BA School of Business and Finance, Latvia, Address: 161 Valdemara Str., Riga, Latvia, LV-1013; Tel.: +371 67387317, fax: +371 67320620, Corresponding author: janis.grasis@ba.lv.

The Parliament of the Czech Republic adopted the New Civil Code on February 3, 2012. It entered into force from 1 January 2014, and created a new legal instrument in the Czech Republic: trust funds ('svěfenský fond'). The norms of international private law have also enabled the recognition of foundations, trusts, and similar foreign trust-like structures in the Czech Republic (Ronovská & Lavický, 2015). The author of the present Article defended dissertation paper "The Essence of Trusts, its Recognition and Legal Regulation in the Roman – German Law System Countries and Possible Introduction in Latvia" on September 12, 2008. The shortened version of the dissertation paper is published in the monograph in Latvian "Legal regulation of the trusts and its possible introduction in Latvia." (Grasis, 2008) In the mentioned dissertation paper and monograph, considering that trust instrument is not incompatible with Continental law system, the author has prepared special draft law on trusts for the needs of the credit institutions in Latvia. The Czech Republic was more pro-active to introduce trust instrument in its domestic regulation, and therefore it has adopted trust regulation quicker than the Republic of Latvia.

Problem Statement

As Latvia would like to join Organization for Economic Cooperation and Development (OECD), in the recent years Latvian state institutions, especially Ministry of Finance, has negative opinion on introduction of the trust instrument in the internal legislation. The main argument is that OECD as an organization is against trusts. Therefore this article briefly outlines the fundamental characteristics of the new legal regulation in the Czech Republic, which already is the Member-state of OECD. In the present work comparative analyze is done in order to prepare similar regulation in the Republic of Latvia.

The New Regulation of Trust Instrument in the Czech Republic

The essence of the economic function of the trust is to divide management from enjoyment of property. For this to happen, a trustee should have basic power to manage and dispose of the trust property just as a full owner would. While there are several ways to endow the trustees with powers of management and alienation, this is achieved in the English trust by requiring the settlor to do everything within his power to transfer the title of trust property to the trustee. By vesting ownership of the trust property in the trustee, the arrangement allows him to act in his own name without inconvenience of regularly seeking authorization from the settlor or beneficiary for his dealings with the property (Ho & Lee, 2013).

Section 1448 of the Civil code gives the following definition of the trust: "A trust is created by setting aside part of the property owned by the founder in such a way that the owner entrusts the trustee with the property for a particular purpose through a contract or disposition *mortis causa*, and the trustee undertakes to keep and administer the property" (The Civil Code of the Czech Republic, 2012). The creation of a trust establishes separate and independent ownership of the part of property and the trustee is obliged to assume the property and its administration. The rights arising from the right of ownership in the property in a trust are exercised by the trustee in his own name and on the account of the trust; however, the property in a trust is not owned by the administrator or the founder, or the person entitled to receive a performance from the trust.

We have to compare the mentioned definition with the definitions given in the Principles of European Trust Law (Hayton, Kortmann & Verhagen, 1999) and in the Hague Convention on the Law

Applicable to Trusts and on their Recognition (Hague Convention, 1985). According to the European Principles of Trust Law, trust is defined as follows: “In a trust, a person called the “trustee” owns assets segregated from his private patrimony and must deal with those assets (the “trust fund”) for the benefit of another person called the “beneficiary” or for the furtherance of a purpose.” Article 2 of the Hague Convention on the Law Applicable to Trusts and on their Recognition contain the following trust definition: “The term “trust” refers to 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. A trust has the following characteristics –

- a) the assets constitute a separate fund and are not a part of the trustee's own estate;
- b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.” (Hague Convention, 1985). In general the definition in the Czech Civil Code corresponds to the definitions of the trust in the European Principles of Trust Law and Hague Convention on the Law Applicable to Trusts and on their Recognition. However there is one small difference: the trust itself is by definition a separate autonomous entity, and the assets of the trust does not all vest in the trustee. Probably, this nuance could create some practical problems in dealing with persons outside the Czech Republic. Simultaneously such approach is not innovative in the world – Czechs follows the same way like in the Quebec: under the Quebec Civil Code, ownership is not vested with the trustee or indeed any party. Instead, the Code grants the trustee the full set of powers that are typically available to the owner. According to the Articles of 1261, “The trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right” (Civil Code of Quebec 1994); and Article 1278 “A trustee has the control and the exclusive administration of the trust patrimony, and the titles relating to the property of which it is composed are drawn up in his name; he has the exercise of all the rights pertaining to the patrimony and may take any proper measure to secure its appropriation” (Civil Code of Quebec 1994). It means that a trustee acts as the administrator of the property of others charged with full administration. The Civil Code gives to the trustee, in the broader terms, the “exercise of all the rights pertaining to the patrimony”.

Establishing the Trust Instrument in the Czech Republic

In order to establish trust according to the Czech Civil Code founder must create a public instrument, which must contain at least:

- a) the designation of the trust (The designation of a trust must express its purpose and contain the words “svěřenský fond”),
- b) identification of the property that constitutes the trust upon its creation,
- c) definition of the purpose of the trust (It may have a publicly beneficial or private purpose - a trust established for a private purpose serves the benefit of a certain person or in his memory; such a fund can be established and for the purpose of investing to make a profit to be distributed among the founders, employees, shareholders or other persons,
- d) the conditions to provide a performance from the trust,

- e) information on the duration of the trust; in its absence, the fund is conclusively presumed to be established for an indefinite period, and
- f) the identity of the ultimate beneficiary or the manner of his determination if a performance is to be provided from the trust to a particular person as to the ultimate beneficiary.

European Principles of Trust Law does not provide specific minimal demands for the content of the trust instrument. The same principle is also in the Hague Convention on the Law Applicable to Trusts and on their Recognition. The only precondition for the validity of the trust is only that it applies only to trusts created voluntarily and evidenced in writing under this Convention (Article 3 of the Hague Convention, 1985).

In the Latvian draft law the obligatory requirements for the trust agreement were the following:

- a) identification of the parties;
- b) identification of the beneficiary(ies) or adequate information in order to identify beneficiary(ies) in the future, in case if beneficiary has not yet born or established;
- c) initial trust assets to be transferred for trust management;
- d) term of the trust;
- e) trust is revocable or irrevocable;
- f) the rights of the beneficiary and his share from the trust assets in case of multiple beneficiaries.

Additionally the following could be included in the trust agreement:

- h) special rights and duties of the trustee;
- i) special conditions for the management of the trust assets;
- j) the name of the trust;
- k) appointment of the trust protector;
- l) action with trust assets after termination of the trust agreement;
- m) another conditions by will of trust settlor and the trustee, which regulates legal relations between trust settlor, trustee, beneficiary and protector of trust (Grasis, 2008, p. 144). If we compare a minimum demands for the trust instrument, then in the Czech Civil Code and Latvian draft law they were very similar.

A trust in the Czech Republic is created when a trustee accepts the authorization to administer it; in case there are several trustees, acceptance of the authorization by at least one of them shall suffice. However, if a trust has been established by a disposition mortis causa, it is created upon the death of the decedent. This regulation again is very similar to the regulation in Quebec: “A trust is constituted upon the acceptance of the trustee or of one of the trustees if there are several. In the case of a testamentary trust, the effects of the trustee's acceptance are retroactive to the day of death (Article 1264 of the Civil Code of Quebec 1994)”.

Trustee could be:

- (1) Any person with full legal capacity.
- (2) A legal person may be a trustee, where provided by a law.

Under the certain conditions, the founder of a trust or the person who is to receive a performance from the trust may also be a trustee. In this case, however, a trust must have another third-party trustee; the trustees must make juridical acts jointly.

Normally a trustee is appointed and removed by the founder. A founder may determine another method of appointment or removal of the trustee in the trust instrument. On the application of a person with a legal interest therein, a trustee is appointed by a court if the person authorized to do so fails to appoint him within a reasonable period.

As mentioned already before, like in the Quebec, a trustee is entitled to exercise full administration of the property in a trust. A trustee is registered in a public or other register as the owner of the property in a trust with the note “svěřenský správce” (trustee).

Ultimate Beneficiary

The trust beneficiaries each have an enforceable right to compel proper administration of the trust by the trustee in accordance with the terms of the trust and the trustee's powers and duties (Cane & Conaghan, 2008). According to the section 1457, a founder has the right to appoint the ultimate beneficiary and determine the performance to be provided to him from the trust, unless the instrument of the trust determine otherwise (The Civil Code of the Czech Republic, 2012). If the founder fails to exercise his rights to appoint beneficiary of the trust, the trustee shall appoint the ultimate beneficiary and determine the performance to be provided to him from the trust. In the case of a trust established for private purposes, a trustee may exercise that right if the trust instrument determine the group of persons from which the ultimate beneficiary may be appointed. An ultimate beneficiary may be granted the right to the fruits and revenues from the trust, or the right to property from the trust, or, where appropriate, the share therein.

In case, a person, who is authorized to appoint the ultimate beneficiary or determine the performance to be provided to him from the trust, shall proceed in accordance with the trust instrument and at his own discretion. He may change or cancel his decision under the conditions determined by trust instrument. No one person is authorized to appoint the ultimate beneficiary or determine the performance to be provided to him from the trust for his own profit.

If a trust has been established for private purposes, an ultimate beneficiary's right to such a performance is created no later than after one hundred years from the establishment of the trust, even where the trust instrument determine a later time. However, even after one hundred years, an ultimate beneficiary may acquire the right to such a performance if he is entitled under the trust instrument to get a share of the property no later than upon the extinction of the last right to the fruits or revenues, as well as if he was a contemporary of the founder or a child of the founder or of his contemporary, provided that, according to the trust instrument, he is to succeed no later than upon the death or termination of the ultimate beneficiary who, given his order, precedes him, in order to be the following ultimate beneficiary to acquire the fruits or revenues; throughout his life, other persons may acquire fruits or revenues along with him.

If a trust has been established for private purposes, an ultimate beneficiary's right to fruits or revenues is extinguished no later than after one hundred years from the creation of the trust; however, in the case of individuals, such a right may last until his death. Similarly also in Quebec “The right of beneficiaries of the first rank opens not later than 100 years after the trust is constituted, even if a longer term is stipulated. The right of beneficiaries of subsequent ranks may open later but solely for

the benefit of those beneficiaries who have the required quality to receive at the expiry of 100 years after the constitution of the trust (Article 1272 of the Civil Code of Quebec 1994)”.

During the existence of a trust, an ultimate beneficiary has the right to request that in conformity with the trust instrument he be provided with a relevant performance. An ultimate beneficiary of a trust established for private purposes may waive his rights by means of a declaration made in the form of a public instrument. In the case of a right to fruits or revenues and in the absence of any other ultimate beneficiary to whom such a right could pass, it passes to the ultimate beneficiaries who are entitled to the right to property from the trust.

Supervision over the Administration of a Trust

Supervision over the administration of a trust is exercised by the founder and a person designated as the ultimate beneficiary, or by other persons if so determined by the trust instrument. In the cases provided by a statute, the administration over a trust is supervised by another person or a group of persons, or a public body. If a trust has been established for the benefit of the ultimate beneficiary who does not yet exist or cannot be determined on the date on which the fund is created, the founder shall appoint a person authorized to supervise the administration of the trust in the interests of the ultimate beneficiary. If this is not possible, or if the founder is inactive, a court shall appoint such a person on the application of the administrator or a person with an interest therein.

According to the Section 1465, The trustee shall, without undue delay, deliver to the person with a statutory right to supervise the administration of the trust a notification in which he shall state at least the designation, purpose and duration of the trust and his name and address. The notification is not necessary if the person authorized to supervise is already aware of these facts (The Civil Code of the Czech Republic 2012). On the request of the person with the right to supervise the administration of the trust, the trustee shall allow the documents of the trust to be checked and submit to him the requested accounts, reports or other information.

The founder, an ultimate beneficiary or any other person with a legal interest therein may apply to the court to order or prohibit the trustee to perform a certain act, or to remove the trustee and appoint a new one. These persons may also invoke invalidity of a juridical act whereby an administrator damages the trust or a right of the ultimate beneficiary; however, if a third person has acquired a right in good faith, it must not result in its detriment. On the application of the person, a court shall authorize such a person to initiate or pursue proceedings in the interest of a trust instead and in the name of a trustee, if the trustee is inactive without sufficient cause. If a trustee, founder or ultimate beneficiary participates in acts aimed to intentionally harm the rights of the founder's creditor or harm the trust, they are liable jointly and severally. Also according to the law in Quebec, “The court may, at the request of an interested person and after notice has been given to the persons it indicates, appoint a trustee where the settlor has failed to do so or where it is impossible to appoint or replace a trustee” (Article 1277 of the Civil Code of Quebec 1994)”. In case of fraud by the trustee, settlor or beneficiaries, law in Quebec provide solidary liability: “The trustee, the settlor and the beneficiary are solidarily liable for acts in which they participate that are performed in fraud of the rights of the creditors of the settlor or of the trust patrimony” (Article 1292 of the Civil Code of Quebec 1994)”.

Modification of a Trust

According to the new Czech regulation of the trust, on the application of a person with a legal interest therein, a court may decide that a trust be cancelled if it is impossible or difficult to achieve its purpose, primarily due to circumstances which are unknown or unpredictable to the founder. Where a trust has been established for a publicly beneficial purpose, a court may decide to replace its original purpose with a similar one. If, in accordance with the original intention of the founder, it is possible to achieve or better benefit the purpose of the trust by changing the fund's instrument, a court shall amend the trust instrument. Before making such decision, the court shall seek the opinion of the founder or his legal successor, the trustee, ultimate beneficiary and the person entitled to supervise the trust, unless they are applicants. Similarly it is stated also in the Civil Code of Quebec: "Where a trust has ceased to meet the original intent of the settlor, particularly as a result of circumstances unknown to him or unforeseeable and which make the pursuit of the purpose of the trust impossible or too onerous, the court may, on the application of an interested person, terminate the trust; the court may also, in the case of a social trust, substitute another closely related purpose for the original purpose of the trust" (Article 1294 of the Civil Code of Quebec 1994).

Termination of a Trust

As indicates M. Lupoi, the final term of trusts is a serious problem in English law, where it is seen more specifically as the period within which the vesting of the right transferred to the trustee must take place in favour of the final beneficiaries. This is typical of "family" trusts, where the settlor wishes the trust to terminate only when certain circumstances have come to pass and not simply after the lapse of a certain period of time, which might be insufficient or excessive with respect to his intentions (Lupoi, 2000). According to the Czech approach, the administration of a trust shall end upon the expiry of the period for which a trust has been established, by achieving the purpose for which a trust has been established, or by a decision of a court (Article 1471, The Civil Code of the Czech Republic 2012). If a trust has been established for private purposes, its administration shall also end in case all ultimate beneficiaries waive their right to receive a performance from the trust.

Upon the extinction of the administration of a trust, a trustee shall surrender the property to the person entitled thereto. An ultimate beneficiary and, in his absence, the founder of the trust are presumed to be entitled to the property; in the absence of both, the property passes into the ownership of the State.

If the administration of a trust established for a publicly beneficial purpose is extinguished because it is impossible to fulfil that purpose, a court shall, on the application of the trustee, decide that the property will be transferred to another trust or into the ownership of a legal person aiming to achieve a purpose which is as close as possible to the original purpose of the trust. Before making the decision, the court shall obtain the opinion of the person entitled to supervise the administration of the trust. But in case, the trust instrument provides for another manner in which property should be disposed of upon the extinction of the trust, then the later will be in force.

If we compare regulation in the Czech Republic and in the Province of Quebec, we again could find similarities: "A trust is terminated by the renunciation or lapse of the right of all the beneficiaries, both of the capital and of the fruits and revenues. A trust is also terminated by the expiry of the term or the fulfilment of the condition, by the attainment of the purpose of the trust or by the impossibility, confirmed by the court, of attaining it. (Article 1296 of the Civil Code of Quebec 1994).

Conclusions

The Czech Republic has become one of the first countries in the Eastern Europe, which has modernized internal civil laws (Civil Code in the Czech Republic) by introducing a trust instrument. It is not a quasi-trust, when trustee manages trust assets based on civil contract. Example of quasi-trust we could find in Latvia. According to the “Regulations on the Performance of Trust operations” passed by Financial and Capital Market Commission of the Republic of Latvia on December 21, 2001, trust operations performed by Latvian commercial banks are based on the contract signed between the settlor and the trustee (Latvian commercial bank) and therefore the settlor of the trust remains the legal owner of the trust assets. In order the commercial bank could offer trust operations, the contract must be in writing, where clearly is indicated the rendered services, powers, obligations and liability of the parties. In the Article 6 of the Regulations it is stated that trust contract shall specify the following matters:

- 1) which party brings market risks,
- 2) the total amount of the trust assets,
- 3) possible investment types and total amounts,
- 4) on which behalf – the credit institution or the client – the acquired financial instruments shall be registered,
- 5) beneficiary and the procedure how the profit shall be distributed,
- 6) procedure of how information regularly shall be provided to the beneficiary about changes of the value of trust assets,
- 7) that credit institution are obliged to manage the trust assets as a careful owner (Regulations on the Performance of the trust operations 2001). In Latvian case, there is not the transfer of the ownership from trust settlor to the trustee – credit institution; it means that settlor remains the legal owner of the trust assets. Practical examples approves that legal regulation is imperfect also. In the Article 1 of the Credit Institutions Law it is stated that credit institution is liable only for separation of the clients trust assets from the assets of the credit institution. (Law on Credit Institutions 1995) Therefore there must be amendments that credit institution is liable to the client for damages resulting from the trust management, in cases of evil intent, gross negligence or in case of breach of the trust agreement. Just now in the bilateral agreement credit institution could put the client in less favourable situation.

According to the Czech regulation the trust assets are separated from the assets of the founder or trustee. In the classical Common law trust, once the trust has been constituted, the settlor no longer has any enforceable rights in respect of the trust property unless the settlor reserved such rights at the outset. For example, by making himself or herself one of the beneficiaries of the trust, or by including a right to revoke the trust as one of the terms of trust (Cane & Conaghan, 2008). It also corresponds to the main principles of the Principles of European Trust Law and definition of the trust in the Hague Convention on the Law Applicable to Trusts and on their Recognition. The Czech regulation on trusts is based on the sample of the similar legislation in the Canada – Province of Quebec, which has civil law jurisdiction. Therefore we could use the Czech regulation on trusts as model for the introduction of the trust instrument in Latvia.

Future Work

The results of this analysis will be used for legislation process in the Republic of Latvia in order to improve trust regulation in Latvia and to persuade Ministry of Finance of the Republic of Latvia, that OECD is not against introduction of the trust instrument in the OECD Member-states. OECD demands only strong rules against money laundering, also relating to the trusts.

Acknowledgement

I would like to thank professor Dr.iur. Juris Bojars from the University of Latvia for his contribution to my dissertation paper and his inspiration to continue scientific research in the field of trusts and international private law.

References

- Amos, M.S. (1937). The Common Law and the Civil law in the British Commonwealth of Nations. *Harvard Law Review*. Vol. 50, p. 1263.
- Cane, P. & Conaghan, J. (2008). *The New Oxford Companion to Law*. Location: Oxford: Oxford University Press. pp. 1196-1197.
- The Civil Code of the Czech Republic (2012). Retrieved from: <http://www.czechlegislation.com/en/89-2012-sb>, date: 10.03.2016.
- Civil Code of Quebec (1994). Retrieved from: http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/CCQ_1991/CCQ1991_A.html, date: 10.03.2016.
- Grasis, J. (2008). *Trastu tiesiskais regulējums un tā iespējamā pārņemšana Latvijā/Legal regulation of the trusts and its possible introduction in Latvia*. Location: Rga: Banku augstskolas finanšu un pētniecības centrs.
- Hague Convention on the Law Applicable to Trusts and on their Recognition* (1985). Retrieved from: <https://www.hcch.net/en/instruments/conventions/full-text/?cid=59>, date: 10.03.2016
- Hayton, D. (2011). *The International trust*. Location: Bristol: Jordans.
- Hayton, D., Kortmann S. & Verhagen H. (1999). *Principles of European Trust Law*. Location: Kluwer Law International – W.E.J.Tjeenk Willink.
- Ho, L. & Lee, R. (2013). *Trust Law in Asian Civil Law Jurisdictions. A Comparative Analysis*. Location: Cambridge: Cambridge University Press.
- Lupoi, M. (2000). *Trusts: a Comparative Study*. Location: Cambridge: Cambridge University Press.
- Credit Institutions Law (1995). *Law of the Republic of Latvia*. Retrieved from: <http://www.fktk.lv/en/law/credit-institutions/laws/4529-credit-institution-law.html>, date: 10.03.2016.
- Trasta operāciju veikšanas noteikumi/Regulations on the Performance of Trust operations (2001). *Financial and Capital Market Commission of the Republic of Latvia*. Retrieved from: <http://www.fktk.lv/en/law/credit-institutions/fcmc-regulations.html?start=20>, date: 10.03.2016.
- Ronovská, K. & Lavický, P. (2015). Czech Republic: Foundations and trust funds in the Czech Republic after the recodification of Civil Law: a step forward? *Trusts & Trustees*, Volume 21, Issue 6, pp. 639-644.