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# The Panamanian foundation

Outlining a Panamanian tool in tune with Latin American planning needs.

A number of structures are available to help arrange the financial affairs of Latin American families across generations. The historical and cultural traditions of the different Latin American nations may affect which estate-planning vehicles are desirable in different jurisdictions. There are, however, a number of common themes. By touching upon how this part of the world has received the common-law trust, perhaps we can identify some of these themes.

## The civil–law tradition

Most countries in Latin America have a civil code based on the Spanish civil code, which in turn was a codification of legal institutes developed over time from Roman law. In addition, most countries have adopted codes of civil procedure, criminal codes, commercial codes, tax codes, etc., all intended to make the common man aware of his rights and obligations. The need for ‘predictability’ in the law is therefore an important characteristic of the Latin American legal tradition.

Because predictability is of the essence, a civil-law judge may interpret the law and apply his interpretation to a particular case, but may not create a legal precedent that is binding for other cases. The inability of the judiciary to significantly shape the law may explain why clients in Latin America do not fully appreciate the value assigned by a common-law professional to the 500-plus years of legal tradition that stand behind the trust and prefer to retain the controls and other elements of ownership in their family structures.

## A misunderstanding of the role of a trustee

The use of the common-law trust as an estate-planning tool may have become unpopular because of horror stories regarding the exercise of ‘ownership rights’ by a trustee and the expensive gymnastics that may have to be employed to replace them. Latin Americans prefer to view a trustee’s role under agency principles and rarely understand why giving up legal title is necessary and why an owner would need to rely on a non-binding letter of wishes and a distant judicial system to adjudicate issues. An estate-planning vehicle that allows flexibility to remove and appoint new administrators would be an attractive tool.

## Split ownership

Latin Americans have a conceptual problem dealing with the notion that two people can own the same property, one as legal owner and the other having an equitable title. Over centuries, our legal system never found the need to make the distinction, nor to create a body of law based on equitable principles and fiduciary duties. A finding that there is a ‘breach of trust’ to hold an administrator liable or focusing on the intent of the owner to set aside a ‘sham’ transfer of property are not necessarily useful concepts. A civil-law court would probably approach these issues as a matter of contract law

and focus on the following questions: Have all conditions been met for an effective transfer of title? Does the party in possession hold the assets as owner (with the intent to act as such)? Or are they simply an agent, depositary or custodian?

The civilian concepts of ownership and possession are central themes around which the law of property has devolved in Latin America. Ownership is viewed as a series of rights or attributes that may be dismantled and shared temporarily with others (a usufruct, for instance) or transferred absolutely on condition that they be employed in a particular manner (as in a fideicomiso), but only one person is deemed as a matter of law to have ownership. Thus a civil-law tool that can effectively convey ownership on condition that the property be used in a particular manner or for a specified purpose should be well received.

## Absolute control

Obviously no one wants to give up control over the administration or disposition of property. A decision to do so must be driven by significant tax, asset protection, or similar concerns and one must be prepared to be able to credibly explain the advantages of doing so: not an easy task in a part of the world where personal riches have been built through centralised, closely held family concerns.

Even if a head of family is prepared to transfer such power to a trustee, he or she will often want to severely restrict discretion to the point that a ‘letter of wishes’ becomes much more than an expression of intent. Control being a central issue, a tool that sets precise rules that must be followed as a matter of contract law is perhaps a more marketable approach.

## The Panama private interest foundation

In June of 1995, Panama adopted Law No. 25, which regulates the Panamanian private interest foundation. Instead of trying to ‘fit’ or redefine the common-law trust in civilian terms, Panama opted to address some of the common themes mentioned above by creating a stand-alone juridical entity to own, administer and dispose of property for non-charitable private purposes. The acceptance of this tool has been overwhelming.

The Panama statute defines the foundation as a patrimony that has juridical existence, created to become effective immediately or upon the death of the founder, out of assets belonging to the founders or contributed by others, earmarked for the purpose of carrying out one or more specified objectives, under the control of a council with broad powers to invest and dispose of the foundation assets and its income for the benefit of one or more beneficiaries.

The private interest foundation is based on a legal concept that can be traced to the Roman Empire and to the very foundations of civil law. Originally, under Roman law the fundatio did not exist as a separate entity; rather it consisted in the act of leaving assets to an existing person charged with a

moral duty to apply them to meet certain ends, often to the care of a Roman soldier's family. Later, with the consolidation of Christianity in the Middle Ages and the establishment of charitable institutions focused on Christian concerns, the foundation gained recognition as an entity having its own patrimony and a separate juridical existence.

We shall focus on three important elements of this Roman law institution that have survived in the Panamanian statute and which should help to understand why this tool has been so well received in Latin America: (i) foundations are juridical entities created by contract; (ii) they have a patrimony with a legal existence separate from the patrimony of the founder or beneficiaries; and (iii) they are not a fiduciary arrangement.

## (i) Juridical entity

During the Middle Ages, in the part of the world that follows Germanic and Anglo-Saxon common-law traditions, incorporated entities were only available to the few who could obtain a charter from the State and unincorporated arrangements had to take the form of a fiduciary transfer of title, as was the case of the trust. In contrast to the little latitude allowed by the common law, in the civil law the use of incorporated associations grew considerably during the same period without requiring a charter or much State supervision.

The right to freely fix the terms of a business association agreement or 'pacto social' is a central theme in the laws of countries like Panama that adopted the liberal 19th century Spanish civil code. Thus, in the mind of a Latin American civil lawyer, it is not a difficult task to accept a foundation as a juridical person created by contract in the exercise of a founder's 'free will'.

## (ii) Separate existence

The foundation has been compared to a corporation, deemed under civil law to have a separate existence from its shareholders or owners. However the corporation cannot exist independent of its shareholders, while the foundation, once created by the founder, may continue to exist without regard to the continuing existence of its founder, although exceptionally a founder may reserve certain powers. This important difference makes it an ideal estate-planning mechanism.

Thus, once the charter or acta is registered, the foundation acquires a personality of its own and all assets transferred to it constitute a separate patrimony from that of the founder, which cannot be attached, placed under embargo or otherwise pursued except for obligations incurred by the foundation itself.

In light of the above, any rights reserved by the founder that may affect the continued existence and independence of the foundation, as well as any residual rights of ownership reserved by the founder or anyone transferring assets to the foundation, should be carefully considered.

### (iii) No fiduciary duty

The foundation's charter must include, amongst other things, the names of the members of the foundation's managing board, which is known as the 'foundation council'. The council, for the most part, is the governing body and has the responsibility of administrating the assets of the foundation and making distributions to the beneficiaries.

Except to the extent limited by the appointment of a protector or other supervisory body, the council enjoys broad administrative and dispositive powers, subject to the statutory duty of employing the care that a good family man or bonus pater familias would employ when managing and caring for his own property.

But to whom is this duty owed? One could argue that the duty is owed to the founder, but the continued existence of the founder is not essential and certainly advancing such a theory would place the foundation more in line with agency law principles, a result contrary to the intent of the statute.

Is the duty owed to the beneficiaries? From a historical perspective it may be concluded that since the concept of equitable title does not exist in the civil law, and was not an element of its Roman ancestor, beneficiaries are therefore accidental participants that may be removed at will and do not have a vested interest in the foundation's property, at least initially.

Is the duty owed to the foundation itself? Since a duty cannot exist without a corresponding right, it would appear that in the same way a Board of Directors owes a duty to its corporation the foundation council should be held to an equivalent responsibility; but who can enforce this right? A protector? A beneficiary acting for the foundation? A founder that no longer exists?

The statute does not provide a clear answer to these questions. What is clear is that based on contract principles much can be done to address these issues by careful drafting of the charter and regulations.

## Conclusion

The private interest foundation offers an exciting flexible civilian approach to estate planning, devoid of the common-law requirements of divestiture and limited only by the creativity of the founder and rules of public policy, of which they are few. As long as the structure created fulfils minimum statutory requirements, for the most part, a foundation can be tailor-made to meet the estate-planning needs of Latin American clients that share the common concerns discussed above.



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