COMMENT

THE ESTATE PLANNING PROCESS IN THE PHILIPPINE CONTEXT: SUBSTANTIVE AND PROCEDURAL ISSUES IN PROTECTING THE RIGHTS OF THE ESTATE OWNER*

*Edson T. Eufemio***

Estate Planning in the Philippines is a shared discipline. When the legal profession speaks of estate planning, what is really referred to is the execution of notarial wills, or the disposition of a client's estate *inter vivos*, such that an estate owner is made to effectively dispose of his estate among his heirs and even among strangers while he is still alive, the intention being to avoid, sometimes at all costs, the imposition of estate taxes.

When the accounting profession speaks of estate planning, what is being referred to is tax planning, or seeking the most economical way of transferring an estate owner's particular properties using all available loopholes in the tax system. Accountants also carefully consider the transfers' implications on the estate owner's personal income tax, and seek the lowest possible income tax bracket for him.

Bankers also claim to do estate planning and when they refer to it, what they really mean is that their banks are offering certain financial services such as those involving trust arrangements which will help individuals with high net worth manage their assets efficiently for the benefit of intended beneficiaries, often with the promise of making the trust *res* or the trust *corpus* grow in value; of course, upon payment of the appropriate trust fee.

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* The author is the Executive Director of the Financial and Estate Planning Association of the Philippines (FEPAP), a network of professionals from various disciplines dedicated to educating the public through seminars, lectures, and publications, about the benefits of Financial and Estate Planning. *Cite as* Edson Eufemio, *The Estate Planning Process in the Philippine Context: Substantive and Procedural Issues in Protecting the Rights of the Estate Owner*, 79 PHIL. L.J. 840, (page cited) (2004).

** Vice-Chair, PHILIPPINE LAW JOURNAL (1993). Partner, Eufemio Law Offices. M.B.A. (2004), LL.B. (1994), A.B. Psychology (1990), University of the Philippines.

Financial planners also claim to do estate planning. In the Philippines, unlike in other jurisdictions, there is no formal personal financial planning industry. In the United States and Canada, for example, this consists of personal finance professionals who have undergone adequate training and have completed certain requirements to be board-certified personal financial planners (CFP). Most CFP boards are self-regulatory agencies. However, these agencies are backed by statutory regulation.

In the Philippines, the lack of formal regulation means that financial advice is sometimes dispensed by the most unexpected sources, and these lack proper training and adequate knowledge of even the most basic personal finance theories. This is why the pyramiding scams of 2002 were so successful, where the middle income sector's personal savings were diverted and "invested" in fly-by-night financing companies after unbelievable interest rates were offered. Greed was not the culprit; they simply did not know any better. Still, the few personal financial advisers who have trained in other jurisdictions offer their financial expertise in the Philippines, and when they refer to estate planning what they really refer to is simply finding of the means to preserve wealth in accordance with a personal financial plan.

Finally, life insurance agents also perform estate planning, and when they say that, what they really mean is that an individual can "instantly create an estate" by simply dying, if he has life insurance. The intention here is to have something to leave behind, even if a man has no substantial properties.

Precisely because estate planning is a shared discipline in the Philippines, its full benefits have failed to reach the general public. Since no single profession owns it, no single profession promotes it; there is a diffusion of responsibility. While statistics are not readily available, the need for estate planning can be inferred from the many estate disputes among family members pending before the courts. Such services must also be made available to those in the middle-income and lower-income brackets.

This article seeks to explore the legal and financial infrastructure where estate planning as a discipline will hopefully mature from its current infancy. It aims to scrutinize whether or not this infrastructure is capable of adequately incubating the infant concept, or whether changes in substantive and procedural laws are required if estate planning is to attain full maturity.

I. ESTATE PLANNING AS A DISCIPLINE

Estate Planning should now be looked upon as a separate discipline apart from the different component professions and disciplines that contribute to its process. Indeed, the sum is greater than its parts, and a multi-disciplinary approach is needed to provide the estate owner with all possible benefits.

In its traditional sense, estate planning was deemed a component of personal finance, or financial planning as it is known and practiced in other jurisdictions. The trend is that both Financial Planning and Estate Planning should be treated separately, but in close coordination with each other. Estate Planning is different from Financial Planning since Financial Planning refers to the wealth creation process, while Estate Planning refers to the wealth preservation process.

Combining the two disciplines, however, the following definition is proposed for Financial and Estate Planning (FEP): "The process of managing one's financial goals so that he gets to accumulate wealth throughout his lifetime and eventually gets to preserve then transfer this wealth to his intended beneficiaries upon his death with the least cost."

The whole process of Estate Planning aims mainly to preserve the estate owner's wealth under the existing legal infrastructure. Current tax laws impose estate taxes in a graduated schedule in accordance with an estate tax table based on the net estate value. Current laws on succession also impose very strict conditions on who inherit and in what shares. The Civil Code, specifically, imposes legitimes on each estate owner, partially restricting his freedom to dispose of his property.[1] Both greatly affect how one's estate is passed on to one's heirs and must be addressed.

II. THREE MODES OF DISPOSITION IN ESTATE PLANNING

Estate planning speaks of the transfer of properties from the estate owner to his intended beneficiaries or transferees. There are three available modes of disposition: sale, donation, and succession. The Civil Code defines each:

> By the contract of sale one of the contracting parties obligates himself to transfer the ownership and to deliver a determinate thing,

[1] CIVIL CODE, Art. 886-914. More often than not, the free portion which estate owners may dispose of to strangers or persons other than compulsory heirs is small. Other jurisdictions allow the free disposition of their entire estate. It is submitted that in the Philippines, personal wealth is meant to be kept within the family.

> and the other to pay therefore a price certain in money or its equivalent.[2]
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> Donation is an act of liberality whereby a person disposes gratuitously of a thing or right in favor of another, who accepts it.[3]
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> Succession is a mode of acquisition by virtue of which the property, rights and obligations to the extent of the value of the inheritance, of a person are transmitted through his death to another or others either by his will or by operation of law.[4]

The law impliedly allows estate planning to be done using any of the three, as the estate owner is not restricted from availing of any of the three modes. Of course, each mode has its own set of restrictions, so the basic principle is that if an estate owner is not happy with the restriction of one mode, then he should choose from the other modes.

Sale and donation are what are called *inter vivos* transfers, taking place while the estate owner is still alive. Succession as a mode of disposition is a transfer *mortis causa*, and takes place only upon the death of the estate owner.[5]

Of course the formalities effecting each differ. A sale must be effected by a deed of sale, a donation must be effected by a deed of donation, and succession must be effected through a will, which is governed by a detailed set of formalities.

III. WILLS

There are generally two kinds of wills allowed in the Philippines if one distinguishes with respect to the time they take effect. These are the testamentary will and the living will. The Civil Code refers only to the former, and is the kind most commonly known to the public and the legal profession.[6]

The living will is allowed by implication, and is a will that can, loosely speaking, take effect while the estate owner is still alive. Its objective

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2 Art. .1458.

3 Art. 725.

4 Art. 774.

5 Art 777.

6 Art 783.

is to leave instructions to the family when the estate owner becomes critically ill, comatose, or suffers some mental disability or other illness such that he can no longer manage his affairs. The living will can be very similar to a testamentary will in the sense that it is intended to leave behind instructions for his heirs, but the instructions in a living will are intended to be observed while the estate owner is still alive. The law does not prohibit the execution of a living will and does not impose any formal requirements for its effect, unlike the formalities required of a testamentary will which must be substantially complied with to take effect.[7]

Of course, the instructions in a living will can only refer to such instructions on medical and health care. For example, it may provide that he be allowed to die should he be left in a condition where he is mentally unconscious but physically is alive due to a respirator ("termination of life" instructions). With the advances of medical science, it will not be too far in the future when patients may be kept physically alive long after they become mentally deceased. This can have many legal implications, such as when a comatose father is being kept alive by a common-law wife and not "allowed" to die in order to prevent the legal (but estranged) wife and the children from acquiring the estate. In the meantime, the common-law wife will continue to enjoy the estate as *de facto* administrator.

Since Philippine law is generally silent on living wills, some issues arise. First, if provisions relating to termination of life are included in a testamentary will, do they have to undergo probate?[8] Second, if the heirs refuse to comply with the instructions in the living will, does a voluntary heir, or even a stranger such as the State, have the legal standing to seek the implementation of the terms of the living will? Third, are living wills void despite noncompliance with the formalities required for testamentary wills?

Returning to testamentary wills, their provisions must be clear. For example, an annulment of an heir's marriage, or a divorce where a foreign spouse is involved, may cause complications. An estate owner may have left property to his son and his son's wife, but in case of an annulment, under the rules of community property, the property will have to be partitioned between the former spouses. This may not have been the intention of the

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[7] Art. 804-819.

[8] Art. 838. "No will shall pass either real or personal property unless it is proved and allowed in accordance with the Rules of Court."

testator, so testamentary conditions may be imposed in the will before co-ownership is given to both husband and wife.

Wills, however, enjoy inherent advantages as estate planning tools. First, the estate owner retains full control over all his assets and properties until his death. He need not become dependent on his children, relatives, or professional administrators or managers. Second, the estate owner retains control of his estate's disposition. Specifically, he may dictate which property or business is left to which heir, subject of course to the rules on legitimes. Third, the estate owner may freely designate his executor.

Apart from testamentary dispositions, wills may also be used to leave other instructions. For example, the testator may wish to donate his organs to medical research.[9] Or, he may wish to be buried in a certain way, or have certain songs played at his funeral. He may leave instructions on where he wants to be buried, or that he wishes to be cremated. He may leave instructions on how he wants his family to celebrate his birthdays after he passes away, or instructions regarding family traditions he would want the family to continue to observe, such as the Christmas reunion, weekly mahjong sessions, annual out-of-town excursions, or spiritual and religious devotions.

In general, the will is a perfect tool for the estate owner who intends to impose testamentary conditions on the heirs, legatees and devisees. It allows the estate owner to control the ownership and possession of his estate until his death, and thereafter to even control the manner and extent of the disposition.

IV. TRUSTS

Trusts are fast becoming a popular tool for estate planning, because of the degree of control that the estate owner can retain over the disposition and enjoyment of the property by the beneficiary.

Our laws expressly recognize trust arrangements.[10] However, in creating a trust, the estate owner must still resort to any of the three modes of disposition. Thus, the corresponding legal disposition must first have tc

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[9] Rep. Act No. 349 (1948) , *amended by* Rep Act No. 1056 (1954).
[10] CIVIL CODE, art. 1440.

be effected, including the payment of all transfer taxes. The trust itself is also deemed a separate entity for taxation purposes.[11]

From the trustor's point of view, legal protection against abusive, negligent, or disobedient trustees is needed, especially for trust arrangements which will take place after his death, when he can no longer ensure the trust's enforcement in accordance with his wishes.

For example, a trustor may transfer complete ownership of a piece of property to a trustee for the benefit of his beneficiary. But what if the beneficiary is a minor and the trustee does not reveal the existence of the trust property? Or what if the beneficiary predeceases the trustee and the trustee chooses to dispose of the property instead of complying with the trustor's intentions and turning the property to a substitute beneficiary? At present, no government agency has the power and authority to ensure that trust arrangements are complied with. While a trust arrangement over real property may be annotated on a title and filed with the Register of Deeds, that office is merely a depository. It will be up to the private parties concerned, such as the beneficiary himself, to seek redress from the courts. Unfortunately family squabbles and resort to litigation is not what the trustor-estate owner originally intended, and perhaps was what was even sought to be avoided.

V. INSURANCE

Life insurance may be seen as both a financial planning and an estate planning tool. It is the former when a priority is placed on dividends, cash value or living benefits. It is the latter when a priority is placed on shielding the estate against depreciation after one's death, by providing additional liquidity to pay taxes and other settlement costs, and income replacements to beneficiaries. Life insurance is an instant estate builder, and ensures that one's beneficiaries receive something regardless of one's circumstances. Further, insurance provides an instant source of cash to pay off all liabilities contingent on the estate owner's death, such as estate taxes, funeral expenses, and medical bills. None of the heirs may have the liquidity or even the inclination to pay these expenses when they become due.

However, life insurance is not required by law, and the current social security benefits are insufficient to ensure that beneficiaries or heirs are adequate supported when the income-generating family member passes

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[11] TAX CODE, § 60.

away. While powerful, it is not taken advantage of by the general public, and neither is it popular among estate planners who are in the legal or accounting professions.

VI. FAMILY HOLDING CORPORATIONS

On the other hand, the use of family holding corporations continues to enjoy popularity among estate planners as a wealth preservation tool despite its dubious ability to actually save on taxes and transfer fees. In fact, examining the National Internal Revenue Code, it is likely that more taxes are incurred when forming a holding corporation than when outright transfers of the property by sale, donation, or trusts are made.

True, exemptions from capital gains tax can be obtained when transfers of properties are made from the individual estate owner to a corporation of which he is the majority stockholder.[12] However, the exemption is only temporary, and any subsequent transfer of the shares of stock results in the reimposition of the capital gains tax. Moreover, documentary stamps tax are imposed on shares issued in exchange for the property, as well as on the shares owned by the estate owner which are to be transferred to the heirs. This is in addition to the documentary stamps tax issued on the original shares of the corporation, annual, quarterly, and monthly reportorial requirements, and other fees required by different government agencies. In the end, strictly from the point of view of tax-savings, the family holding corporation is unpalatable.

However, this is not to say that the family holding corporation is useless as an estate planning tool. For example, it can be used to ensure that certain properties are kept within a family line. This would mimic the Civil Code's *reserva troncal*, but would not be restricted to cases of an ascendant inheriting from a descendant.[13]

To illustrate, shares of stock may be distributed to family members alone, excluding spouses and in-laws but including descendants in the direct line. A shareholder agreement may then be put in place, prohibiting shareholders from disposing of shares to persons other than the existing

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[12] § 40. "No gain or loss shall also be recognized if property is transferred to a corporation by a person in exchange for stock or unit of participation in such a corporation of which as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation."

[13] CIVIL CODE, art. 891.

shareholders. Other provisions may ensure that the corporation's management and control are entrusted to specified members of the family. Of course, the terms of the shareholders' agreement have to be put in place before any transfer of properties, to avoid or at least prevent possible legal disputes.

VII. THE FAMILY BUSINESS AND MANAGEMENT SUCCESSION

An estate can consist of all property capable of ownership.[14] This article has so far discussed individual properties, but what if the property to be included in an estate is an entire business, including not only its tangible assets, but its goodwill, trade secrets, management style, business reputation, and good relations with customers and suppliers?

Take the example of an estate owner whose only source of wealth is a small retail trading business, which is in the form of a sole proprietorship. He has four children, all of whom are of age. Three are already financially independent. The youngest, however, is the only one who helped her father manage the business, and who continues to do so. The father only leases the space on which the business operates, thus his only tangible assets are actually the inventory, office equipment, and any cash in the bank.

The cash in the bank is easy to divide among the four children. But what if the estate owner intends for the family business to continue? Remember that the youngest is financially dependent on its continuation, and in all probability is the most qualified to continue the business. How does the estate owner ensure the continuation of the business, and, moreover, that it will be continued by the youngest child as manager and owner?

Obviously, without proper estate planning, there is a potential family dispute should the father suddenly die intestate. The youngest child will most probably insist on continuing the business, and the other children will most likely agree in exchange for a share of the operating profits. But who is truly entitled to receive the income? What is fair is really something for the siblings to decide, since one way will seem fair to one side and unfair to the other.

Since no laws exist on the management succession of family businesses, the general rules on succession will apply. The estate owner will

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[14] Art. 776.

thus have to make specific provisions in his will regarding the management of the business. However, there seems to be no guarantee that the other siblings who were not chosen to run the business will not use their shares in the business, if any, to out-vote the designated manager-successor.

VIII. SETTLEMENT OF ESTATES AND FAMILY DISPUTES

In Article 1083 of the Civil Code, the estate owner is expressly allowed to prohibit the partition of the estate among the heirs for a period of twenty years. But what if all the co-heirs agree to a partition before the twenty-year period? Who will protect the wishes of the estate owner?

The procedural laws governing probate and the settlement of an estate allow heirs to come to an amicable settlement on issues governing the will even if the terms of the amicable settlement do not conform to the testator's wishes. In this respect, these procedural laws do not offer much protection to the estate owner. They are designed for the benefit of the heirs, and are sometimes used by one heir against another out of self-interest, in the end frustrating the deceased testator's wishes.

Indeed, special procedures are in place with respect to the probate of a will, and disputes between and among family members or among heirs, are common despite wills' clear provisions. The sad thing is that when heirs are in dispute a will's probate and its observance, the case really becomes a case of litigating parties seeking their own material interests. The interests of the estate owner are made subservient to the interests of the heirs, and if any amicable settlement is reached, these are approved by the courts ironically as "not being contrary to law, public morals, or public policy," even though contrary to the wishes of the testator.

IX. PROTECTING THE RIGHTS OF THE ESTATE OWNER

What substantive and procedural changes to the law may be effected to afford more protection to estate owners?

An estate owner who executes a will is primarily concerned that the instrument will be probated in accordance with his intentions, and that all beneficiaries enjoy what is bequeathed to them, in the manner and extent he intends. Currently, the law impliedly allows the testator to seek judicial affirmation that his will is valid while he is still alive:

> The testator himself may, during his lifetime, petition the court having jurisdiction for the allowance of his will. In such case, the

> pertinent provisions of the Rules of Court for the allowance of wills after the testator's a death shall govern.
>
> The Supreme Court shall formulate such additional Rules of Court as may be necessary for the allowance of wills on petition of the testator.
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> Subject to the right of appeal, the allowance of the will, either during the lifetime of the testator or after his death, shall be conclusive as to its due execution.[15]

Perhaps the Supreme Court can designate an office to act as a depository of wills, such that wills filed with this office have the effect of being judicially declared as valid, and may no longer be subject to question by heirs upon his death. This of course presupposes that the testator-petitioner has fully disclosed the properties which constitute his estate. Upon review, the said office can then issue a Certificate of Validity declaring the will to have been validly executed. This will give the testator the peace of mind he needs, knowing that his will, upon probate will not be impugned by self-serving heirs, legatees, or devisees.

The rules on legitimes should also afford the estate owner more free portions. Currently, the laws allow very small free portions, with the legitimes taking up most of the estate pie. This prevents the estate owner from giving more properties, for example, to his favorite child, whom he feels is more deserving. By forcing the estate owners to comply with the rules on legitimes, an estate owner is forced to give more or less equal portions to the prodigal son and to the diligent and respectful son, which may not be fair to both the estate owner and to the dutiful son.

It is submitted that the law should also afford more flexibility to estate owners in terms of taxes. For example, transfer taxes on an estate owner who is planning his estate by "selling" properties to his compulsory heirs pursuant to an approved estate plan should be lower compared to transfer taxes on sales to strangers.[16]

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[15] Art. 838.

[16] *See* Tax Code, § 99(B).

X. ESTATE PLANNING AS A PROFESSION: THE NEED FOR STANDARDS AND REGULATION

Estate Planning is actually expressly allowed, though in a very restricted sense, by the Civil Code:

> Art. 1080. Should a person make partition of his estate by an act *inter vivos*, or by will, such partition shall be respected, insofar as it does not prejudice the legitime of the compulsory heirs.

Despite this, even without express imprimatur from statutes, estate planning is an inherent right in property ownership. However, like financial planning, it is not as simple as transferring properties to designated beneficiaries. It may involve planning other aspects such that family disputes among heirs are also avoided.

In the Philippines, legal concerns are not the only ones that stand in the way of bringing the benefits of estate planning to the public. Cultural factors also exist since people rarely enjoy discussing mortality, especially their own. Further, children bringing up the benefits of estate planning to parents will seem like eager gold diggers.

Estate Planning should be treated as a profession, and estate planners should be board certified in the Philippines, after having been adequately trained and duly licensed. Thus, a law should be enacted regulating the financial planning and estate planning industry, creating a governing board or agency to oversee the training, competence and trustworthiness of people who will hold themselves out as financial or estate planners. The benefits of financial and estate planning can only be really enjoyed by the public if the industry is regulated, so that the real planners will be distinguished from the charlatans.

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