The trust as a means of intergenerational wealth transfer in the UK and Europe in the light of the EU Regulation on Successions

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Table of contents: 1. Introduction. – 2. Property and succession. – 3. The trust institution. – 4. The Hague Trusts Convention. – 5. The EU Regulation. – 6. Conclusions.

1. Introduction

Where there is wealth there is the problem of the transfer of wealth. In particular, given that we must all die one day, there is the problem of the transfer of the wealth between the generations. This especially applies in relation to the transfer of businesses and business assets between the generations.

Intergenerational wealth transfer creates specific difficulties when it concerns the transfer of businesses.

The first is that a business gets better as the persons who own and manage it become more experienced and know how to deal with the difficulties that may arise in it. That means that the owner of a business, may well feel that it is simply getting better and better, and more and more valuable. He may therefore be reluctant to dispose of it to someone who is less experienced, such as his child. On the other hand, the child upon reaching adulthood is always very eager to inherit from the parent. The child may press the parent to retire and leave the child to run the business. Children always think they know better than their parents, because they have the new ideas and the enthusiasms of youth, but also youth's naivety. The older generation is reluctant to hand over control, not only because the older generation is aware of the naivety and the lack of experience of the younger, but because the older generation fears growing old without the security of wealth and wants to hang on to it as long as possible. In addition, the older generation fears that without the wealth in its hands, the younger generation will not respect, or listen

to, or look after the older generation. But then, as I have already said, there is the certainty of death.

Sooner or later it will be necessary that the older generation passes on control to the younger, from natural causes, if not from deliberate choice. The question for me is how the institution of the trust can help in the process of transfer.

2. Property and succession

In the civil law legal systems of Continental Europe and beyond, all derived from Roman law, the concept of ownership of property is based on the Roman law idea of *dominium*. This is the notion that, in principle, there should be *one* person who has *all* the rights in relation to a thing. Therefore, if there are any real rights which are less than *dominium* – which we can call ownership of a thing – these lesser real rights form a closed list of exceptions to the principle of *dominium*. This closed list is often referred to by the Latin phrase, the *numerus clausus*. The inheritance of property in the civil law world is managed by using a device which was exposed in its classical theory by the French jurists, Aubry and Rau[1]. This is the concept of patrimony. Each person has – must have – a patrimony, but only one patrimony. All things of economic value pertaining to that person form part of his patrimony. These things may be positive in value, such as assets, or negative in value, such as liabilities. They may be things which the person now has, or they may be things which the person will have in the future. The essence of patrimony is nothing less than the economic personality of a human being. When a person dies, that economic personality is transmitted directly to the heir. Consequently the heir, in an economic sense, *becomes* the deceased. If, in principle, the debts of the deceased outweigh the assets, the heir will find himself paying those debts without sufficient assets to back them up. This is sometimes known as the *damnosa hereditas* of the Roman law.

Inheritance rights since at least the time of the French Revolution have been based also on the principle of equality between a multiplicity of heirs and solidarity between the generations. This last idea has led to the idea that heirs had certain fixed and indefeasible rights in the patrimony of their deceased parents[2].

(1) *Droit Civil Français*[5], 1917, vol. 5, p. 332-382.

(2) Art. 536-552 c.c.

This is sometimes known as forced heirship, or compulsory inheritance. It means that the deceased is not free to give away more than a certain proportion of his patrimony on his death. More than that, because the patrimony is (fictitiously) treated on death as still comprising assets given away during some or all of the deceased's lifetime, the share of the patrimony to which each heir is entitled is enlarged with retrospective effect, and, if what is left on death is not enough to satisfy the enlarged entitlement, claims may be made to the assets given away during life(3).

On the other hand, in the common law world, the position regarding both property and inheritance is completely different. First of all, the idea of property(4). The existence of the feudal system in early English legal history meant that, from the beginning, the only person who owned the land was the king(5).6 All other subjects had only certain rights of use in the land. Moreover, the pyramidic structure of the feudal system, with the king at the apex and the tenants in possession at the bottom, meant that, in relation to any particular piece of land, there could be many people who simultaneously claimed some sort of use right in that land. Hence when, over time, these use rights solidified into what we would now regard as property rights, it meant that the English lawyers did not in any way regard ownership as being in principle something which belongs to one person. Instead, they regarded it as axiomatic that many people could each have separate rights in relation to the same land. These bundles of separate rights became known as *estates* or *interests* in the land. This was of course fundamentally different from the civil law idea of *dominium*.

Next, the question of inheritance. Although, at the outset of the English legal system after the Norman conquest, there was a period when it was not possible for a person who died to make a will of *land*, by employing legal techniques developed later, such as the 'use', the forerunner of the trust, in practice it became possible to do so(6). But the most important point to make was that the concept of forced heirship, although present

(3) Art. 553-564 c.c.

(4) See, for example, Castronovo, Mazzamuto, *Manuale di diritto provato europeo*, Milano, 2007, II, p. 26-34.

(5) In theory, at least, this is still true today.

(6) Matthews, *Imperative Inheritance Law, Comparative* Law – United Kingdom, in Castelein, Foqué, Verbeke, *Imperative inheritance law in a late-modern society*, 2009, p. 130-131; Castronovo, Mazzamuto, *op. cit.*, p. 34-35.

in the early stages of English legal history, but being only ever customary rather than statutory, had died out in most parts of England by the fifteenth century(7).From then, until the twentieth century, there was in practice complete freedom of testation(8). Even today this notion survives mostly intact. Thus the notion that underpinned inheritance in England(9) was not solidarity between the generations, but instead owner autonomy. You were entitled to do what you liked with your own property, and there was no use of the concept of patrimony as there was in the civil law(10).

This dichotomy in relation to the analysis of rights of property was important because, in the English legal system, the circumstances permitted the growth of the legal institution which later became known as the trust. Although, similar ideas also flourished temporarily in Roman law and in the civil law systems in Continental Europe generally, they never developed as far as the trust in England. Almost certainly, this is the result of the different approach to property law, and in particular, the lack of the acceptance by the English of the principle of *dominium*. There was no need to have one person who owned all the rights in relation to the thing. It was well accepted that there could be several people, each simultaneously having separate rights in relation to the same thing.

3. The trust institution

The trust in its classical form achieved, and still today achieves, a very important objective in general estate planning. It creates an important, indeed critical split between the *management* of a thing and its *enjoyment*. One person is the owner of the thing and has not only the right and power, but also the duty, to manage that thing for the benefit of the other persons who will enjoy the thing. In making this split, the trust cuts across the civilian notion that the owner of a thing ought to be able

(7) MATTHEWS, *op. cit.*, p. 131-132.

(8) Since 1938 the High Court has had the power to vary testamentary, and since 1952 non-testamentary, dispositions on death which fail to make reasonable provision for certain relatives or dependants of the deceased. But this is largely based on an objective assessment of the *needs* of the claimant. This legislation is now contained in the Inheritance (Provision for Family and Dependants) Act 1975. See MATTHEWS, *op. cit.*, p. 137-151.

(9) Strictly, England and Wales, which together form a single legal system, with laws that differ only slightly in the two countries. Wales now has its own legislature and government, with limited competence. But there is only one judicial system.

(10) See for example KEETON & GOWER, (1935) 20 Iowa LR 326.

to enjoy it beneficially, subject only to the possibility of creating a lesser real right (such as usufruct) which temporarily separates the enjoyment from the ownership. The result is that the trust as a device enables the person who owns a thing to pass on the *benefit* of that thing without passing on its *control*. In such a case, the owner of a thing would create a trust in which he himself was the trustee, although for the benefit of some other person or persons, perhaps his own children or grandchildren. In this way, he still makes all the management decisions in relation to the thing but he does not himself benefit from it.

A more sophisticated version of the same idea would mean that the owner of the property could create a trust in which he was himself the trustee, so keeping control, but although the trust was for the benefit of other people, the trustee himself was also one of the beneficiaries. A different way of using the trust device would be where the owner of a thing did not want to be the trustee, though he did want to create the trust. This could be achieved by the owner transferring the ownership of the thing to a third party for the benefit of those whom he wished to benefit, such as his children. The consequence is that the asset would be in the hands of a third party (who may be a professional) who would manage the property in the interests of the beneficiaries.

A device such as the trust was better able to flourish in the common law world, where the heirs of the deceased did not have any fixed inheritance rights which were indefeasible, and the testator had complete freedom of testation, and moreover, there was no patrimony idea which enabled donations made during lifetime to be brought back on death. In the civil law world, where patrimony and forced heirship were the norm, it was obviously more difficult for a device like the trust to succeed. It would be possible for an heir to object to the trust which the deceased had made during his life just as he could object to a lifetime donation, and the heir could say that he was entitled to a fixed share of the patrimony of the deceased, unlike the heir in the common law world who would not be able to make such claim.

At the same time, there is nothing in principle which prevents a person in the civil law world from creating a trust during his lifetime, provided that he does not thereby offend the indefeasible inheritance rights of any of his heirs under his own system. In practice, of course, you cannot know whether a person has any heirs with indefeasible inheritance rights until that person has actually died. Even if a person gives away property during his life, whilst he has children, it cannot be known, first

of all, that he will still have children when he dies. Secondly, even if he does, it cannot be known that he will remain subject to the law that he was subject to at the time of the gift. If he should become subject, say, to English law before he dies, then it is of course to the English law and not to the civil law that the heirs must look.

There are not many discussions in the civil law text books of what happens if a civil law heir claims in respect of a trust created during the lifetime of the deceased. For example, there is no doubt that an heir who did not receive as many assets on his parent's death as if the trust had not been created could claim to have been damaged by that trust. But it is unclear to what extent, for example, the claim that can be made by the heir would be reduced by the value of any benefits coming to the heir in his capacity as a beneficiary of the trust. For example, if an entrepreneur during his life creates a trust of his family business for the benefit of his children in equal shares and then dies, the children may have forced heirship rights, and may claim that, by giving the shares in the company to a third party trustee, their rights as heirs have been damaged. However, it is not clear what is the measure of their loss, since the economic benefits which they would have had as heirs may already have come, or may come in future to them by way of the trust.

There are a number of ways in which a trust can be used to transfer wealth between the generations.

The first way would be for the owner of the wealth to remain the owner, but to create a trust under which he is trustee, but for himself to retain a life interest (rather like a usufruct) so that he receives the income from the wealth during the remainder of his life. On the other hand, once he dies, the trust effectively comes to an end and the capital beneficiaries are entitled to take the capital from the deceased's estate.

But this is not an inheritance device. It depends upon the trust created during life. Another way of achieving the same result in substance, but without the owner being the trustee, would be for the owner to transfer the wealth to a third party as trustee, but still retaining a life interest for himself and for capital to go to the next generation on the death of the settlor. A third way of doing it would be for the settlor not to create a trust involving a life interest for himself, but instead a trust which can first confer beneficial interests on the next generation straightaway. A fourth way is to transfer the wealth to trustees on discretionary trusts for the next generation. In this case they have no absolute entitlement to the capital, but they will receive it at the discretion of the trustees. A fifth way in which a settlor might deal with the transfer of his wealth would be to create a trust for the benefit of others in the next generation, but to benefit himself only by some contract

of employment with the business itself. For example, he might act as the managing director of the company carrying on the business.

So the various ways in which a trust can be used to transmit wealth between generations are infinite. It is entirely up to the owner as to how the trust works, who gets what and at what time. Obviously, in considering how to structure the trust, the settlor of the trust will be influenced to some extent by other regulatory and fiscal concerns. If a trust structure in one particular format is particularly expensive in tax terms, then the settlor may be persuaded to create a trust in a different format which is less expensive.

4. The Hague Trusts Convention

Before the Hague Convention on the Law applicable to Trusts and on their Recognition, which was negotiated at the Hague in the early 1980s and signed in 1985, the recognition of the trust in non-common law countries (in practice, mainly civil law states) was rather unprincipled and ad hoc. The usual technique adopted in a civil law court was for the court to identify the legal structure or device in that system which the judge considered most resembled the particular trust before the court, and then to assimilate the trust to that kind of institution. So, for example, a simple life interest trust could be assimilated to a usufruct and bare property. Or a will trust might be assimilated to a fidecommissary substitution. A discretionary trust might be assimilated to a foundation, and so on. As long as the trust in question did not infringe rules which were mandatory by virtue of public policy, then, generally speaking, civil law courts were quite prepared to recognise trusts as valid by their systems.

However, the landscape has now changed because the Hague Trusts Convention has created a principled framework within which trusts can be accepted by civil law countries. The Convention has been ratified or acceded to by (amongst other countries) Italy, the Netherlands, Luxembourg, Liechtenstein and Switzerland. France has not ratified the Convention, although it has now produced a trust-like device in the so-called *fiducie*[11], and there is some interest now in considering trusts at least for business purposes. However, fiscal considerations mean that the trust, as a form of liberality is discouraged. Belgium introduced a number of

(11) See Matthews, *The French* fiducie*: and now for something completely different?*, 2007, 21 TLI 17.

provisions dealing with trusts in its new code of private international law[12] a few years ago, which deal with definition, jurisdiction and proper law. This is so even though Belgium has not ratified the Convention.

What this means is that there are a great many more situations in which a trust from a common law country will be recognised in a civil law country, and very often nowadays will be recognised as the Hague Convention wishes, in its own terms as a trust and not as some other kind of device. So a settler from a civil law country may feel more confident now in creating a trust if he knows that the courts of his country will, in fact, recognise and give effect to the trust from a common law state. Certainly, Italians have taken to the trust with enthusiasm. Many articles and books have been written on it[13], many court judgments have been given on it[14], and Italian *dottrina* now recognises the so-called *trust interno*, or domestic trust, where all the elements except the governing law are Italian.

5. The EU Regulation

In addition to this, however, there is now the EU Regulation on Succession1[15] to consider. This regulation (which does not apply to the UK, Ireland or Denmark) was not intended to try to harmonise the substantive rules of succession and inheritance amongst EU members. That would have been impossible. Instead, it was intended to try to produce some harmony among the rules of private international law. This includes rules for deciding on the applicable law and for the jurisdiction

(12) See the Law concerning the Private International Law Code of 16 July 2004, arts 122-125, and Matthews, *Trusts in Belgian Private International Law*, 2005, 19 TLI 191.

(13) See for example Salvatore, *Il* trust *– Profili di diritto internazionale e comparato*, Padova, 1996; Beneventi, *I* trusts *in Italia oggi*, Milano, 1996; Cherubini, Delmonaco, *I* trusts, Roma, 1999; Lupoi, Trusts², Milano, 2001; Canessa, *I* trusts *interni*, Milano, 2001; Zanazzi, *Il* trust *operativo*, Milano, 2001; Bartoli, *Il* trust, Milano, 2001; Buttà, *Introduzione ai* trust *e profili applicativi*, Milano, 2002; Vicari, *Il* trust *di protezione patrimoniale*, Milano, 2003; Lupoi, *L'atto istitutivo del* trust, Milano, 2005; Neri, *Il* trust *e la tutela del beneficiario*, Padova, 2005; Monegat, Lepore, Valas, Trust, Torino, 2007, II; Di Giandomenico, Festa, *Consorzi, fondazioni e* trust³, Rimini, 2007; Berti-Riboli, Ganado, *La legge di Malta sui* trust, Milano, 2007; D. Zanchi, *Il* Trustee *nella gestione dei patrimoni*, Torino, 2009; Stesuri, Portelli, *Il* trust², Napoli, 2009; Lupoi, *Istituzioni del diritto dei* trust², Padova, 2011; Ceccaroni, *Fondi patrimoniali*, trust *e patti di famiglia*², Milano, 2012.

(14) See for example the cases collected in Aa.Vv., *La giurisprudenza italiana sui* trust³, Milano, 2009.

(15) Regulation (EU) No 650 of 2012, of 4 July 2012 (l. 201/107).

of certain courts in EU to deal with the problems which arise from the inheritance.

The regulation, however, extends beyond these matters to cover, for example, the recognition of enforcement of judgments on succession matters from other EU member states and also the recognition and effect of authentic instruments (ie notarial acts) from other member states, as well as the introduction of a European certificate of inheritance, which will give some important and useful information to the courts of a country where the deceased's property is to be found about the law of inheritance which is, in fact, applicable to the succession by virtue of the regulation. It will apply to the successions of persons who die on or after 17 August 2015.

However, it is important to notice that this regulation also has a few words to say about trusts. Article 1 paragraph 1 says this:

«This regulation shall apply to succession to the estates of deceased persons. It shall not apply to revenue, customs or administrative matters.»

And then paragraph 2 of Article 1 says this (in part):

«The following shall be excluded from the scope of this regulation:

…

(g) property rights, interests and assets created or transferred otherwise than by succession, for instance, by way of gifts, joint ownership with a right of survivorship, pension plans, insurance contracts and arrangements of a similar nature, without prejudice to point (i) of Article 23(2);

…

(j) the creation, administration and dissolution of trusts;
(k) the nature of rights in rem…»

It will be seen that there are a number of exclusions from the scope of the regulation which may involve trusts. As it says, the exclusion in (g) is subject to a provision in Article 23(2). This provision reads as follows:

«That law (ie the applicable law determined under Article 21 or 22) shall govern in particular:

…

(i) any obligation to restore or account for gifts, advancements or legacies when determining the shares of the different beneficiaries…»

The true effect of this exclusion is rather obscure. But it may well mean that a gift made in the life of the owner is excluded from the scope of the regulation except so far as it is required by the applicable law to restore or account for such a gift, for example, in calculating the patrimony of the deceased for the purposes of ascertaining the indefeasible fixed shares of the heirs.

More important in our context is paragraph (j). This applies directly to trusts. It seems to suggest that *any* kind of trust is excluded from the scope of the regulation. This is problematic for a number of reasons. First of all, exception (g) for lifetime gifts is subject to the obligation to account for gifts in relation to ascertaining the shares of heirs. But, if we treat exception (j) at face value, it would seem that a lifetime trust is completely outside the scope of the regulation, and there is no similar obligation to account for the value of the trust so created. On this view, then, a lifetime trust created by an Italian, but governed by English law according to the Hague Convention, appears to escape the EU Regulation and (at least if the trustee and the trust assets are in England or another common law state) to fall outside the jurisdiction of the Italian courts and the rules of Italian inheritance law.

Secondly, exception (j) does not distinguish between lifetime trusts and trusts contained in the will. You can easily understand the argument for saying that lifetime trusts should be outside the scope of a regulation on wills and successions (subject only, perhaps, to the 'clawback' needed fictitiously to reconstitute the patrimony with lifetime gifts, as in exception (g)). But it is harder to understand why trusts in the will should *all* be excluded in the same way, because after all a trust in a will can do the same things for the benefit of third parties as a straightforward gift in a will can do.

Thirdly, exception (j), even in relation to *will trusts*, does not distinguish between (a) will trusts which carry out or further the administration of the estate of the deceased (*eg* collecting in or selling or managing the assets, or paying debts), and (b) will trusts which have substantive effect for the future, *eg* a gift to X on trust for A for life with remainder

to B. One might argue that the second of these should fall outside the scope of the EU Regulation, because it concerns, not *the setting up*, but the *operation* of a structure which has nothing to do with succession. Instead it has only to do with relations between the trustee, beneficiaries and third parties, just like a beneficial gift in a will to X. If a stranger damages the property given to X, it is X who will defend the interests of the trust (or the beneficial gift), and who will rely, not on succession law, but on ordinary principles of property law. On the other hand, a trust which furthers the administration of the trust surely is part of the succession transmission mechanism, and arguably should be covered by the regulation.

Undoubtedly, this makes it difficult to know how exception (j) will be interpreted by the CJEU, the only organ which can give a definitive view. Trusts created by Italians as domestic trusts (*trusts interni*) will not however be a problem. The EU Regulation will not be needed in such cases. But where a trust created by an Italian, transferring wealth between generations, is not a *trust interno*, the EU Regulation will apply, unless exception (i) excludes it. At this early stage in the life of the Regulation, it is impossible to be sure what the answer is.

As already stated, the regulation will not apply to the UK, Ireland or Denmark. So, if an Italian acquires a house in London, and later dies, the succession to the house will be governed exclusively by English law, as English private international law refers questions of succession to immovables to the *lex situs*(16), and English law gives complete freedom of testation to testators not domiciled in England(17).

6. Conclusions

The trust is a long-established legal institution in the common law world, which permits property to be held is ways not otherwise provided for by the local legal system. In particular, it permits retention by the settlor, or the centralisation in another person, of control of the asset, whilst distributing the benefits which flow from it to other persons. Moreover it is inherently flexible, and can be moulded to the form

(16) *Eg Re Hernando* (1884) 27 Ch D 284 (testate succession); *Duncan v Lawson* (1889) 41 Ch D 394 (intestate succession). The rule is the same in Ireland.

(17) See *eg Agulian v Cyganik* [2006] EWCA Civ 129.

needed for the particular case. It is therefore potentially of great use for the purpose of intergenerational transfers. Since the Hague Trusts Convention, there is a much greater acceptance by civil law states of the trust as a trust, as least as long as it does not offend rules of public policy in the specific case. This facilitates its use by owners of property in such states. The new EU Succession Regulation complicates matters by providing an obscurely worded exception for trusts that makes it uncertain whether a trust, whether created in the settlor's lifetime or on his death, is or is not excluded from the scope of the regulation. But since the regulation will not apply to the UK or Ireland, it will be possible to avoid the regulation anyway so long as the asset concerned is an immovable situated in one of those countries.