RUSSELL-COOKE | SOLICITORS

"And death shall have no dominion"

And death shall have no dominion.
Dead men naked they shall be one
With the man in the wind and the west moon;
When their bones are picked clean and the clean bones gone,
They shall have stars at elbow and foot;
Though they go mad they shall be sane,
Though they sink through the sea they shall rise again;
Though lovers be lost love shall not;
And death shall have no dominion. [1]

Citizens and cross-border estates

For the transnational lawyer the present European situation is equivalent to that of a traveller compelled to cross legal Europe using a number of different local maps. Sadly the maps are all in different colours and to different scales and although they use many identical signs these often actually represent different hazards. Some maps overlap and cover some identical areas, but actually disagree, whilst other maps do not even meet, leaving some parts completely uncharted.

Finding a client without some cross border succession issue is becoming increasingly difficult. Does a spouse or partner have a different nationality or domicile? A little digging often reveals a foreign domicile of which the client was unaware. If so, does a community matrimonial regime apply? Does a child or other potential beneficiary or heir reside in a state which taxes on a receipt basis? In a world which is globally interlinked, it is now common for clients of even quite moderate means to have assets situated in another state. A holiday home owned abroad is now very common. The traditional response to any foreign issue was that the client, whilst alive, should consult a lawyer in the other jurisdiction. Why is this not sufficient and what do you do after a death?
In the UK, immovable property is always subject to the local succession law, whilst movables are governed by the law of domicile. UK situated assets are always subject to IHT as are the worldwide assets of persons domiciled or deemed domiciled, subject to one of the 10 current double tax treaties.

[1] Dylan Thomas 1933.
I trust that this Anglo-Welsh poetry will soften any offence caused by the lazy use by me of the short hand "England" rather than "England & Wales" in this article.

Other states have completely different private international law rules. The most common, being that succession law is governed by the local internal law of the nationality and that the entire estate both movable and immovable is governed by that law. Send the client to the Outer Mongolian (OM) lawyer to prepare a Will for OM assets and he is likely to be sent straight back, saying that British law must apply and that a British Will should deal with the OM assets. A surviving partner is often puzzled to learn that the law in Scotland is different to that in England & Wales or Northern Ireland.

For tax purposes, it is usual for the beneficiary or heir to be taxed on whatever they receive rather than the estate being taxed on whatever it contains. If the beneficiaries are resident in Ireland or Germany, is a gift expressed to be free of tax, to mean that the gift is to be free of the Irish or German tax the beneficiary must pay. Will this result in grossing up? Will the credit the beneficiary receives be passed on to the UK executors and reduce the UK IHT payable?

Cross-border issues arise whenever a client holds assets in more than one jurisdiction or has a Will made under the law of another jurisdiction or has a factor linking the client with another jurisdiction.

In find it is increasingly rare to find a client, who does not have such connections:

- property abroad, whether a holiday home or stock options,
- a child who is now living and working in a different jurisdiction,
- a parent, spouse, partner or cohabitee who was born overseas or who has a different nationality.

An Orange Broadband survey in 2006 estimated that one million Britons currently have an LDR; a long distance relationship with someone the other side of the world.

Any of these facts can raise cross-border issues.

The Private International Law ("PIL") Position

"Private international law is that part of law which comes into play when the issue before the court is so closely connected with a foreign system of law as to necessitate recourse to that system"[2].
PIL deals primarily with the application of laws in space and time. The local jurisdiction at a particular time is sovereign and can define as it wishes, and place a boundary at that or any other time as it thinks appropriate. Unlike garden fences, the boundaries created by separate jurisdictions are rarely co-terminous, and can be in different places at different times. No man is an island, but the law certainly is. Each jurisdiction has its own separate and distinct Private International Law rules which do not mesh with that of another.

It is common in all private international law, however, to consider separately, issues of:

- *Jurisdiction* – do the Courts of a state have jurisdiction in the first place?
- *Applicable Law* – if they do, which state's laws will be applied? and

[2] Private International Law – Cheshire, North and Fawcett 14th Edition

- *Recognition and Enforcement* – if the Courts of a state make a particular order, will that order be recognised in the Courts of a different state?

Characterisation

Characterisation (also known as classification) was invented as a legal issue at the end of the nineteenth century, but not introduced to England until the mid 1930's. The topic is known as *qualification* in French and as *qualifikation* in German law.

Once a court has satisfied itself that it has jurisdiction, it must then decide the nature of the legal issue before it. Different categories or classes of topics of law will have different connecting factors. A matter of contract may be governed by the Rome Convention (and in due course the Rome I Regulation). Jurisdiction and recognition in a matter of divorce may be governed by the Brussels II *bis* Regulation.

The more difficult question is as to which rules of classification of which State should be applied. The choice is usually between using the rules of classification of the law of the forum, or the rules of the state whose law is to be applied, although this can produce circular arguments. In England, in practice, the law of the forum, i.e. English rules of classification are used. The rules of classification themselves, are always influenced by the international law issues involved.

As an example, the local English distinction between real and personal property, gives way to the more universal distinction between movable and immovable property.

Examples of English classifications and their connecting factors are:

Validity of Wills as to Form

Under the Hague Wills Convention, any usual connecting factor at the time of execution or death, will suffice.

Succession

The relevant connecting factor is that at the date of death. However how is "the Estate" at date of death defined? What about civil law *patrimoine* during life or some shorter period?

Trusts

The applicable law on creation or from time to time?

Property Rights

Situs is usually the connecting factor. Is there a distinction between movable and immovable property?

Matrimonial (and same sex) Property Regimes

The relevant connecting factor is usually that at the date of the marriage. For England is this the dual domicile or the intended matrimonial home theory? Subsequent changes to residence, domicile or nationality may or may not have an effect and the availability of a subsequent change to the regime may or may not be recognised.

Recognition of Same sex and non-matrimonial relationships

The relevant connecting factor is likely to be that at the date of the formation of the relationship. For English PIL it is likely to be the place of registration but for others may be the personal law of the party for example nationality.

Inter vivos transfers/gifts

Situs, depending upon the nature of the property involved.

Characterisation and Conflicts

Whilst differences in the definitions of contract, tort and marriage have not produced significant problems, the differences in the definitions of succession are fraught with difficulty.

The problems are two fold:

- another state does not characterise at all - e.g. trusts do not exist as a classification in France. (Although some French lawyers might disagree)
- another state characterises differently - e.g. in England, succession consists of the estate at death, whilst in France, succession consists of the *patrimoine* including all assets owned during lifetime and given away before death and also includes all issues involved in the administration of the *patrimoine* as well as succession. The French definition of the classification of the *patrimoine* therefore includes the English separate classifications of succession, gifts and administration.

Classification is currently a matter for the law of the forum and therefore different *fori* will produce different answers. It is therefore vital to get to the right forum. If a choice of law may affect the choice of forum, such choice may have considerable knock-on effects.

The Issues for cross border Capital Taxation

Mismatches of Connecting Factors for Taxation

The fact that different states may use common law domicile, deemed domicile, civil law domicile, tax residence, habitual residence, nationality or *situs* of either the donor (or the deceased) on the one hand or the donee (or heir or beneficiary) on the other, means that either some assets are not taxed at all, or some assets are taxed twice.

- UK taxes UK assets and the worldwide assets of someone dying domiciled or deemed domiciled in the UK.
- Ireland taxes Irish *situs* assets and the worldwide assets of someone dying Irish resident or ordinarily resident because they die within 3 years of being resident in Ireland and the worldwide assets received by an Irish resident beneficiary or a beneficiary ordinarily resident in Ireland because they have been resident within 3 years. (Non-domiciles must be resident for 5 years in Ireland before they become liable)
- USA taxes US *situs* assets and the worldwide assets of someone dying a US national or resident such as a green card holder
- France taxes French assets and those of someone dying resident in France and in some cases taxes beneficiaries resident in France
- Spain taxes Spanish assets and worldwide assets received by beneficiaries resident in Spain
- The Netherlands taxes Dutch assets and those of someone dying within 10 years of being Dutch resident
- Germany taxes German assets and those of someone dying within 5 years of being resident in Germany and beneficiaries within 5 years of being resident in Germany (extended to 10 years for both cases involving the US/German double tax treaty)

Some of these problems are resolved by double tax treaties, but there are very few of these, and they themselves create differences and unfairnesses.

Why should the UK deemed domicile rules apply to a German domiciled person resident in the UK for 17 tax years, but not to an Indian domiciled person resident in the UK for 17 tax years (so that UK IHT is not payable on non UK assets, provided only that they do not pass under a UK Will)?

Where there is no double tax treaty, unilateral relief is available. However this only helps when the same taxpayer is taxed in a similar way at the same time in relation to particular property.
If property is taxed in France on death A but not in England, and taxed in England but not in France on death B, unilateral relief is of no assistance.

Mismatches of Classification for Taxation

If a *usufruct* is classified in the UK as a settlement within the relevant property regime for Inheritance Tax purposes, but classified in a civil law jurisdiction as a valid gift which splits value, there will be very different tax consequences in each jurisdiction.

The Impact of Succession Law

Immovable property in England & Wales and worldwide movable property of English domicilliaries can be transferred under English law without restriction [other than subject to the provisions of the rules protecting dependents – Inheritance (Provision for Family & Dependents) Act 1975].

Immovable property elsewhere and moveable property of non-English domicilliaries is subject to the succession law of another state.

From a UK perspective:

- An English domicilliary can leave his cash and shares to his spouse or civil partner or to charity and they will receive it exempt from IHT
- A French domicilliary, deemed domiciled in the UK, with 3 children must leave ¾ of his cash and shares to them and they will be subject to IHT at 40% if not protected by the double tax treaty. He is not free to choose an IHT free option.

Other states have taxation systems that take into account their succession laws, so that generally forced heirs are taxed at lower rates – often between 8 and 20%. Virtually all European civil law systems, tax on an acquisition basis and tax heirs and beneficiaries at differing rates depending on the closeness of their blood relationship to the deceased.

Whilst spouse exemption may be gathering pace in Europe, children and parents are generally taxed at significantly lower levels than in the UK. Step children and unmarried partners are often taxed at higher levels. If one ignores the complications of the UK limited spouse exemption for assets passing from a spouse domiciled in the United Kingdom to one who is not,

- A French house passing on death of the English owner to his spouse, will now be exempt in both France and England. Unless particular structures are put in place, his children will have forced heirship rights which will trigger UK IHT at 40% if valued at more than £312,000, whilst only at between 5 and 20% if valued at more than each child's French nil rate of €152,850 per child.
- A gift of the French house to a civil partner would be exempt from IHT in UK but subject to 60% tax in France.
- A gift of the French house to a French PACS partner would be exempt from IHT in UK and exempt from tax in France.

Spain has the additional factor of taxing pre-existing rich heirs at higher rates than pre-existing poor heirs.

Will Drafting

The problems of differing private international law rules are brought into sharp focus when presented with the question of how to prepare Wills in a cross border context.

The impossible question is always whether there should be one Will or multiple Wills. In the real world there is no simple answer. If testators can be persuaded to move all assets into one jurisdiction then one Will is sufficient but will not solve all cross border issues. For some jurisdictions such as Spain a separate Spanish Will is extremely sensible, but will not solve all issues. It is self evident that one needs to ensure that one of the separate Wills does not revoke the other, but in practice, the automatic revocation clause in most Wills requires an effort of will to remove. Similarly, a document that may not be regarded as a Will in one jurisdiction such as a US revocable trust or a French *donation entre epoux* may be regarded as a Will in another and thus one law may revoke and another may not. The same applies to doctrines of automatic revocation by marriage or civil partnership for testators domiciled in England & Wales, Northern Ireland or India (other than Hindus) or of the birth of a first child for those domiciled in Scotland or Cyprus. Such revocation may not apply to immovable property situated in another state.

The existence of a Will in another state may complicate matters to the extent that each jurisdiction may well still insist on sight of a fully notarised and translated copy of the grant of probate and Will from the other state to ensure that the local Will has not been revoked.

The case of *Dellar v Zivy, Zivy, Lemarchand and Zivy* [2007] EWHC 2266 (Ch) made it clear that the construction of a Will is presumed to be in accordance with the law of the testator's domicile at the date of execution of the Will, but can be rebutted by any sufficient indication that the testator intended his Will to be construed according to the law of another country. Such intention can be expressed in the Will, or may be implied from circumstances such as his use of a particular language or of expressions known only to a particular law.

In the United Kingdom, a Will and succession law governs the estate at death other than property passing by survivorship. For UK IHT purposes, the tax base includes joint property, property in TSI or IPDI trusts, PETs which become chargeable, GWRs and various other animals.

In most civil law states, succession law and the legitim or forced heirship may bite on assets owned by the deceased but given away, during a period before the death. This may be at any stage during the lifetime, or may be restricted to a period of 5 or ten years. The rights to such clawback may be to the property itself or only to a monetary claim.

How can practitioners find their way through this maze? (Persuading clients to pay for these complications is another matter).

One of the rewards of dealing with this esoteric area, is the licence given to ask direct, impertinent and searching personal questions. Who else is allowed to enquire whether the client has children from a previous relationship, as to details of all previous relationships and about all assets and lifetime gifts?

Find out:

- the place of all assets
- all historic and current connections with other jurisdictions
- the domicile, residence and potential nationalities of all the key players under the laws of all the likely relevant states
- the succession law and tax that will then apply in the UK and the other state
- Draft the UK Will at the same time as the non UK Will, to ensure that they each tie in together for succession law and tax purposes.

It is vital to leave no stone unturned, and discover the place of all assets; to dig through the family history and find all historic and current connections with other jurisdictions; to establish the domicile, residence and potential nationalities of all the key players under the laws of all the likely relevant states.

Only then is it possible to discover where and from whom local advice is necessary. If you can have an idea as to the private international law of that locality, then you will be ahead of the game.

Estate Administration

In relation to the administration of estates, what are the broad issues to be considered?

It will be unusual to be able to deal with another jurisdiction, without an element of local administration being required. Thus, establishing good working relations with local professionals and being easily able to find such local professionals with whom a good working relationship can be established is vital. My address book becomes ever more valuable to me.
Being able to understand the principals of the Private International Law of that jurisdiction and some main issues regarding any relevant internal law, will make communication easier. “Dead men naked they shall be one”, but for the rest of us, an ability to communicate with others who may not use English as their first language, is very helpful.

In the administration of every cross border estate, there are always conflicts and problems which have no easy answer in law; clients wish you to find practical solutions for them at minimum cost. An ability to cut through the Gordian knot and see the bigger picture is extremely useful. However, perhaps the most useful ability is that of being able to foretell the future; the gift of second sight or being able to think ahead and work out what will be needed, not just for the next two moves, but through to the end game. The comparison of cross border estates to three dimensional chess, is apt.

The European Union and the Single Market

The European Union Commission has encouraged the principle of free movement of goods, services and people and thus mobility among European citizens and in commercial activities. Its main objective of cooperation in civil law is to establish better collaboration between the Member States to facilitate the movement of citizens and commercial activities.

Brussels IV Regulation

The European Union Commission is likely to publish the draft Brussels IV Regulation in March 2009, with a view to harmonising Private International Law in relation to Succession and Wills; one can foresee that this may be along the following lines:

For all member states of the European Union:

- the Member State to have the jurisdiction for dealing with the question of Wills and succession of a deceased citizen is to be that of the last Habitual Residence (as defined by the European Court of Justice)
- the relevant connecting factor for both movables and immovables is to be that of the deceased’s last Habitual Residence (and that these rules should also apply to non-European Union citizens)
- Testators should be able to designate the law of their nationality (and possibly as an alternative the law of their Habitual Residence at the time of choice) as applying to the whole of their estate.

It is, of course, open to the UK and the Irish governments to decide not to opt in. Currently, Denmark is outside the proposals, but if the proposed Lisbon Treaty is ratified, Denmark would also have the right to opt in.

If, however, domicile and nationality are to be abolished automatically by regulation as connecting factors for the purposes of European private international law for succession and other connected questions, there will still be many interesting conflicts issues remaining, notwithstanding:

- Domicile or nationality would still be retained as the connecting factor for other preliminary matters, such as the recognition of marriage, registered partnerships, divorce and dissolution, legitimacy and adoption
- Now that Scotland has a different definition for domicile of origin to that of England & Wales, we will begin to see conflicts of law within the United Kingdom
- If, succession law will be more directly enforceable in Europe, what effect will this have on *inter vivos* gifts (which are part of succession law in many states) particularly into trust?
- Domicile and nationality would be retained as a connecting factor for Inheritance and other taxes and double tax treaties, but the likelihood for mismatches between succession law and tax would increase.

Conclusion

As citizens, goods and services move around Europe with increasing regularity, the only way that discrimination between different nationals and residents can be avoided, is if the fundamentals of taxation begin to converge.

Convergence is beginning to emerge with increasing numbers of states with:

- Spouse / registered partnership exemptions
- Instalment option and / or exemption for business and agricultural property
- Exemption for Charities

Differing tax rates may encourage tax competition; underlying differences are likely to see the intervention of the European Court of Justice.
Harmonisation in Europe of the system of taxation of gifts and estates into an acquisitions tax seems to me to be inevitable.

For more information please contact:

Richard Frimston
Partner
020 8394 6217
Richard.Frimston@russell-cooke.co.uk

March 2009