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Cross Border Estate Issues, the European Dimension

1. INTRODUCTION

Cross-border succession issues can arise easily. In the simplest of cases a client might have foreign assets or a foreign will. Another client may have been domiciled or resident abroad or is perhaps a national of another jurisdiction. The same might be said of beneficiaries. All such circumstances give rise to the need to consider foreign succession law and/or foreign estate taxes, as well as the practicalities and law on how an estate is to be administered.

2. LAW APPLICABLE TO THE ESTATE

2.1 Connecting factors

Succession law is linked to jurisdictions by different connecting factors which can increase the complexity of the administration of an estate significantly.

When it comes to ascertaining the law which applies to the estate of a deceased person, different national systems look to these different connecting factors. Most common law countries (Ireland, UK and the USA) look to the deceased's domicile to determine the rules of succession. Some civil law countries look to the law of the nationality of the deceased (Spain, Germany and Italy), whilst others look to the country of habitual residence (Belgium, France and Switzerland).

2.1.1 Domicile

Domicile is used as the connecting factor in Ireland, the UK and the US and also in many Commonwealth Countries. In common law systems, it has a technical meaning which distinguishes it from the concept of habitual residence. Domicile can broadly be defined as a persons natural home, the place where he has set down his roots. It is not necessary for the individual to be resident there. There are three different types of domicile: domicile of origin, domicile of dependence and domicile of choice.

2.1.2 Habitual residence

In contrast to domicile, habitual residence tends to be much more of an objective question of fact and the intention of a person is less relevant than it is for domicile. It is a concept that appears commonly in the law of civil law countries and in EU legislation and the requirements can vary as between countries. In broad terms, it is the centre of a persons living (business, social and family life), the place with which he is most closely associated in his pattern of life accompanied by a regular physical presence enduring for some time. Often residence is defined as being for more than six months in a year. France, Belgium, Switzerland Denmark and Sweden use habitual residence as a connecting factor. However, under Swiss private international law a resident foreigner can expressly choose his national law. Similar elections can be made in some other countries.

2.1.3 Nationality

Nationality is the connecting factor in many European countries including Austria, Germany, Greece, Italy, Portugal and Spain. It is also the connecting factor in South America and Japan.

2.2 Movable v immovable property

In a number of countries the general rule is that the deceased's domicile governs succession to movable property (*lex domicilii*) while succession to the deceased's immovable property is governed by the law of the country in which the property is situated (*lex situs*), regardless of the domicile or habitual residence of the deceased. Such countries are sometimes referred to as 'schismatic' or 'divisional' countries and include Ireland, the UK, France, Belgium and Luxembourg.

Other jurisdictions have one succession rule for movables and immovables, sometimes referred to as 'unitarian or 'unity' countries. These jurisdictions will treat the whole estate in the same way, regardless of whether the assets concerned represent movables or immovables. Unity countries include Italy, Portugal, Spain, Netherlands, Denmark, Germany, Greece and Switzerland.

2.3 Doctrine of *renvoi*

The differing mechanisms by which countries decide what law applies to particular assets can come into conflict. For example, you have an individual who is habitually resident in Ireland, but domiciled (for Irish law purposes) in France. He has movable assets in France. In deciding the applicable law the

French courts will look to apply the law of the country of his habitual residence, i.e. Irish law, but under Irish law it is the law of the individual's domicile that should be applied, i.e. French law. Will the French court having referred the matter to the Irish court, accept the reference back to France and agree to deal with succession to the estate under French law?

The process by which one jurisdiction refers to the law of another is known as "*renvoi*" or referral back. It arises whenever a court is directed by its internal law to consider the law of another state. The country receiving the referral may, under its own law, refer the matter back to the original jurisdiction or onward to a further jurisdiction. Alternatively, the receiving country might accept the referral, either because under its own law succession to that asset should properly be governed by the law of that jurisdiction, or because the country is willing to accept the *renvoi* and apply the law of that jurisdiction notwithstanding that this means ignoring the aspects of international law that would otherwise have referred the matter on to another jurisdiction.

The mechanism for determining the applicable law is therefore as follows:

1. Applying local rules, is it clear that a foreign law applies to the estate?

   In the French/Irish example above, France would refer to Ireland as the deceased's country of habitual residence for the purposes of determining succession to the movables situated in France.

2. If so, what rules are applied by that foreign law?

   In our example, the foreign law (Ireland) applies the law of the country of the deceased's domicile to determine succession to movables.

3. Could the application of those foreign rules give rise to a reference back to that original jurisdiction or on to another jurisdiction?

   In our example, Ireland would refer the matter back to France.

4. Will that reference back (or *renvoi*) be accepted?

   In this case, it is understood that France would accept the reference back and apply French law to the succession.

This is an exceptionally complex area of law. In particular, the circumstances in which a jurisdiction will accept a *renvoi* (and indeed whether a jurisdiction accepts the doctrine of *renvoi* at all) varies enormously from country to

country. It is further complicated by the fact that many countries do not have a fully developed mechanism for dealing with *renvoi* or apply an inconsistent approach in the courts.

2.4 Succession v administration

Under many civil law systems the assets and the liabilities of the deceased automatically and directly vest in their heirs who can either renounce or accept the inheritance. In Belgium, France, Germany, Greece, Luxembourg and the Netherlands heirs will take automatically so that they will have an immediate right to take possession of the estate and they can exercise the rights of the deceased, effectively stepping into his/her shoes. In Italy, for example, heirs must first accept the estate in order to obtain it and do not become automatically entitled to the estate without such formal acceptance.

In other jurisdictions, the estate vests in the personal representatives of the deceased who are empowered to deal with the estate by collecting the assets, discharging any liabilities and then distributing the net assets to the beneficiaries. In addition to Ireland, this is the situation in England and Wales, Denmark, Finland and Sweden.

2.5 Forced heirship, Matrimonial property regimes

Most jurisdictions give some protection to ensure that a deceased's estate does make some provision for dependants. Common law countries usually provide for this by way of the application of the Court's discretion whilst civil law countries give enforceable fixed shares.

Common law systems tend to require dependants to demonstrate that the provision they received from the deceased's estate was inadequate to meet their needs. Civil law systems tend not to look at dependency or need *per se*, but specify that certain individuals (usual children, parents and sometimes a spouse) have a right to receive an inheritance by virtue of their relationship with the deceased.

Matrimonial property regimes and civil partnerships also have an impact on an estate and the entitlements of spouses or partners on death. The important point is to be aware of which regime applies and to which assets.

When dealing with forced heirship the adviser must understand how the individual's assets are dealt with under the applicable succession law or matrimonial property regime, in order to understand the devolution of his or her estate overall. Where possible, the adviser can then seek to tailor the

individual's estate planning to ensure that forced heirship or marital property rules that do not accord with a testator's wishes but which relate only to a certain portion of his assets can be countervailed by planning elsewhere in his estate.

2.6 Clawback

A beneficiary may seek to rely on clawback provisions where lifetime gifts of assets by the deceased resulted in his expected share in an estate being eroded. Clawback provisions, which are a common feature of forced heirship regimes, require assets given away during a person's lifetime (sometimes only during a specified period before his death) to be brought back into account for the purposes of calculating the compulsory share to which the heir is entitled. If the beneficiary's entitlement, as calculated taking into account the gifted assets, is not satisfied by the assets remaining in the estate then the beneficiary (or compulsory heir) can bring an action in the donor's home jurisdiction, seeking to have the gift set aside so that his entitlement can be met.

3. WILLS

In countries (mostly civil law countries) with an established forced heirship regime, the writing of a will is even less common than in common law jurisdictions. However, it has always been recommended that a will is written to ensure the smooth administration of the estate and that assets devolve in the manner decided by the testator. For those of us advising the very wealthy, especially where there are multi-jurisdictional issues, the need to prepare a will is imperative. Above we looked at how the applicable succession law that applies to the assets in an estate is determined, but it is not necessarily the case that a will should be written under that same law.

When deciding the law under which a will should be prepared, there are two key issues. The first is to ensure that the provisions of the will are compatible with the succession law applying to the asset(s) in question and the second is for the will to be recognised in the jurisdiction in which those assets are situated. For the latter, the 1961 Hague Convention has been helpful in establishing a common standard for circumstances in which a will is to be recognised as being validly executed. However, for practical purposes it is often helpful to have the will drawn up under the law of the country in which the assets are situated.

4. TAX

Inheritance or estate taxes are applied in many jurisdictions. The taxes may take the form of a tax on the death estate or alternatively may be a tax on the heirs who receive assets from the estate. As well as applying to assets in the death estate of the individual, inheritance/estate taxes also often apply retrospectively to gifts made during the individual's lifetime.

The circumstances in which taxes are imposed and the reliefs available vary from jurisdiction to jurisdiction, but it is not uncommon to find two (or more) tax charges applying to the same asset or to find that reliefs/exemptions from tax available domestically are not available owing to the multi-jurisdictional nature of the client. Where trusts are involved, or wills are varied after death, the position can become complex.

There are some double tax treaties in place which provide a certain amount of relief but in practice this is limited because there are so few treaties in force for inheritance tax. However, there may be steps that can be taken during an individual's lifetime or through their will to minimise exposure. As a result, the tax position should be dealt with alongside succession planning.

Within the EU there is great potential for conflict between different tax systems and rates. Of the 27 member states, 18 have an inheritance or estate tax, 15 have an inheritance tax and four have an estate tax (the Danish tax is effectively both). When you take account of the existence of clawback, the different exemptions and deductions applying as between member states and also the limitations on relief for double taxation it is clear that the potential for conflict can be great. This goes some way towards explaining the European Commission's desire to harmonise conflict rules relating to cross-border inheritance and estate taxes, see 5.3 below.

5. THE IMPLICATIONS OF EUROPEAN LAW

5.1 Harmonisation – international

The law affecting cross-border estates is complex and can be full of contradicting rules. Multiple attempts have been made at international level to achieve some degree of harmonisation of the rules in order to simplify the legal position and the processes for dealing with an estate. A list of various international conventions that have tackled issues in this area are set out below. The full text of each can be found on the Hague convention website

(www.hcch.net). The list emphasises the fact that this is a difficult area for countries upon which to reach agreement.

- Hague Wills Convention (1961)
  - 40 contracting states including Ireland and the UK
- Hague Administration of Estates Convention (1973)
  - 3 contracting states: Czech Republic, Portugal and Slovakia. Portugal is the only country to have ratified the convention
  - International certificate designating person entitled to administer an estate
- Washington Convention on International Wills (1973)
  - Ratified by 12 countries, including Canada, Cyprus, France, Italy and Portugal
  - Form of international will
- Hague Matrimonial Property Regimes Convention (1978)
  - Ratified by France, Luxembourg and the Netherlands
- Hague Trusts Convention (1985)
  - 12 contracting states including the UK and Switzerland
  - Effect within civil law countries
- Hague Succession Convention (1989)
  - Ratified by the Netherlands only (not yet in force)
  - Choice of law – nationality or habitual residence
- Hague Convention on the International Protection of Adults (2000)
  - 6 contracting states: ratified by Finland, France, Germany, Switzerland and Scotland

5.2 Harmonisation – European Union

For the past ten years the European Union has been looking at how it can harmonise issues of succession law and wills throughout the region. It has already produced Brussels I and Brussels II which deal with issues about jurisdictions and enforcement of Judgments in civil matters and in matrimonial matters and Brussels II (by virtue of a new proposed regulation, Rome III) is being expanded to cover divorce. Now Brussels III (also referred to as Rome IV) is being proposed which will deal with matrimonial property and ownership of property by co-habiting couples or same-sex couples.

Leading up to the publication of the draft EU succession regulation in 2009 (Brussels IV), on 1 March 2005 the European Commission produced a Green Paper on Succession and Wills (COM(2005) 65 Final) stating that there was, "a clear need for the adoption of harmonised European rules". The Commission has acknowledged that full harmonisation of the rules of substantive law in Member States is "inconceivable" and that therefore any

action needs to focus on the rules governing conflicts between the laws of different jurisdictions.

5.2.1 Brussels IV

After much delay, in October 2009 the draft EU Regulation on jurisdiction, applicable law, recognition and enforcement of decisions and authentic instruments in matters of succession and the creation of a European Certificate of Succession (COM (2009) 154) was finally published. It may become more commonly known as Brussels IV, following on from Brussels, I, II and III.

The draft regulation aims to simplify the law affecting those who die having exercised their right to free movement, either by moving to another Member State to live or by buying property in a Member State other than their own. However, one of the difficulties with the draft regulation is that succession means different things in each Member State. For example, in the UK and in Ireland succession means everything to do with what is in your estate at the time that you die; whereas in a country like France, succession not only includes the administration of your estate after death, but it also includes your patrimony and all of the assets you have owned during your lifetime, including gifts that you have made.

The key points in the draft regulation are as follows:

(i) The state of habitual residence is to be the jurisdiction for dealing with all questions of succession.

(ii) Habitual residence is to be the connecting factor to determine the applicable law for both movables and immovables, i.e. a unity rather than a divisional approach is to be taken.

(iii) A testator can elect to apply the law of their nationality as applying to their whole estate.

(iv) The doctrine of *renvoi* is to be abolished and all references to the law of another jurisdiction would be to the internal law of that state.

(v) An EU Certificate of Succession is to be produced. This would be recognised across the EU.

Negotiations regarding the draft regulation are ongoing and some of the issues being considered are whether capacity issues should be included in the

regulation, whether habitual residence should be specifically defined and also whether *renvoi* should be abolished in all circumstances.

The draft regulation does not deal with tax and it also does not encompass family or property law matters. In other words, it deals purely with succession issues. It also does not cover the formal validity of wills and other testamentary documents, leaving the Hague convention of 5 October 1961 to apply, even though this has not been ratified by all Member States. The possibility of a Register of Wills, suggested in the Green Paper, has also been abandoned, though the Commission is separately working in partnership with the European Network of Registers of Wills Association to enable the interconnection within Europe of the registers of wills maintained by Member States.

The draft regulation favours the principles of the civil law system, which is not surprising given that so few member states operate common law systems.

5.2.2 Progress of the regulation and its effects

The UK and Ireland had until 14 January 2010 to decide whether to opt-in to the regulation, neither have opted in but can do so at a later stage, subject to the agreement of other Member States.

Both the UK and Ireland are taking part in the negotiations over the draft Regulation with the hope that ultimately at least part of it can be introduced in each state.

The overriding aim of the regulation is to facilitate the free movement of persons and to reduce the complexity of cross border estates. In my view, this aim remains a worthy one.

Agreement on a final version of the regulation could take some time. The hope is that negotiations might be concluded by the end of 2011 or perhaps early 2012. However, it is understood that even then it could be two years before the regulation comes into force.

For Ireland (whether or not it opts in to the regulation) there will be significant changes in how estates are dealt with that have a European element. Whilst in many respects succession planning should be simplified, there will remain scope for planning given the choice of law provision and through the use of lifetime structures.

5.3 Future EU regulations?

The European Commission is now looking at the possibility of harmonising conflict rules between Member States relating to cross-border inheritance and estate taxes.

In the autumn of 2010 the European Commission ran a consultation on possible approaches to tackling cross-border inheritance tax obstacles within the EU, also wanting to measure the scale of the problems caused. The public consultation paper produced by the Commission noted that of 27 Member States, 18 have an inheritance or estate tax (the former being described as levied on the heirs and the latter on the estate of a deceased person). Of these, 15 have an inheritance tax and 4 have an estate tax. Denmark has both.

The first issue raised by the consultation was that cross-border discrimination might arise on the basis that laws often provide less favourable rules where assets of the deceased were located outside the Member State. The second was that inheritances/assets might end up being taxed in more than one Member State.

The Consultation has now closed and 51 responses were received, including from STEP, which suggested an EU-wide multilateral treaty as a practical solution, and the Institute of Chartered Accountants in England and Wales, which favoured bilateral treaties between the Member States.

The outcome of the Consultation is yet to be seen, but in the meantime no doubt the European Commission will continue to issue infraction proceedings against Member States whose domestic inheritance or estate tax laws are perceived to be discriminatory. Whether as a result of such proceedings, or a pre-emptive action, we are likely to see Member States creeping towards domestic legislation that is more compatible with EU law.

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