STATEMENT OF INTENT

An examination of the potentially landmark ruling of the Paris Court of Appeal with regard to the treatment of trusts under French law

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ABSTRACT

- *The Paris Court of Appeal's decision of 11 May 2016*[1] *was rendered in the context of incomplete trust treatment under French law, and constitutes a judicial response to a lack of legal treatment. As such, it may be a hint of the potential recognition of foreign trusts per se by French jurisdictions from a civil standpoint.*

- *French forced-heirship rules do not defeat contribution to trusts, provided that such trusts are created in conformity with their applicable law and that they are not based, at least principally, on a fraudulent intention. Indeed, the Paris Court of Appeal ruled that 'forced-heirship rules do not constitute fundamental principles of French international public order'.*

1 *Cour d'appel de Paris, 11 mai 2016, n° 14/26247*

A famous French composer, who had been domiciled in California for about 40 years at the time of his passing in 2009, had organised the transfer of his assets to his spouse as universal legatee and sole beneficiary of a trust. His children challenged this transfer and applied to the Paris High Court (*Tribunal de grande instance de Paris*), which rejected their claim. The Paris Court of Appeal (*Cour d'appel de Paris*) upheld the first instance judgment in the decision quoted below.

The composer's protected heirs-at-law and their lawyers proved both imaginative and tenacious as they invoked the French *Constitution*, the *European Convention on Human Rights*, the provisions of the *French Intellectual Property Code* related to the devolution of moral rights, and the 'collecting right' (*droit de prélèvement*) under the 14 July 1819 Act.[2]

2 *Loi du 14 juillet 1819 relative à l'abolition du droit d'aubaine et de détraction*

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The Act granted French heirs the right to collect their full forced-heirship share of an international estate on French assets when deprived of their forced-heirship share pursuant to the provisions of a foreign law. The collecting right had been declared unconstitutional[3] after the composer's death.

Yet, in its decision dated 11 May 2016, the Paris Court of Appeal ruled that the collecting right was not applicable, and that forced heirship does not constitute an essential principle under French law, and, therefore, does not benefit from the protection of the French international public order.

This ruling is particularly relevant, as the testator had contributed his entire estate – in particular, French real estate – to a California trust, in contradiction with forced-heirship rules. In that regard, the Paris High Court had ruled that, as the deceased was domiciled in California at the time of his passing, the law applicable to the movable succession was the law of California, and that: 'The constitution of the J Family Trust must be held as proper and exempt of fraud, pursuant to the laws of the State of California.'

It added that: 'Pursuant to the J Family Trust provisions, according to which [the deceased's surviving spouse] is the sole trustee, and those of Maurice J's will dated 31 July 2008, Stephanie and Jean-Michel J are not entitled to any of the assets subject of these instruments, and cannot request any reduction of gifts or legacies made by Maurice J pursuant to those instruments, as a consequence of the exclusion of French inheritance law.'

3 Conseil constitutionnel, *Décision n° 2011-159 QPC du 5 août 2011*

Overall, the aforementioned decision constitutes a textbook case of international successions involving French heirs-at-law, in terms of both recognition of trusts by French jurisdictions and the reach of forced-heirship rules in an international setting. Its relevance is further emphasised, as it was rendered in the context of the enactment of *Regulation (EU) No 650/2012* of 4 July 2012 (the EU Succession Regulation) prior to the decision – although that regulation was not applicable to this case, due to the death of the testator occurring before its entry into force. From that standpoint, the decision provides useful insight into the future application of the EU Succession Regulation by French jurisdictions.

A TREND TOWARDS RECOGNITION OF FOREIGN TRUSTS IN FRANCE

The recognition of trusts in France has been a slow process, and is still ongoing. To date, from a purely legislative standpoint, the only display of such process has been the enactment of specific legislation directed to taxation of trusts in France. However, French jurisdictions have been recognising (at least some) foreign trusts' effects over the years – but this recognition is still widely incomplete. In that sense, the Paris Court of Appeal's decision, yet to be confirmed by the Court of Cassation (*Cour de cassation*), may be a milestone in a long process.

RECOGNITION UNDER FRENCH LAW WITH REGARD TO TAX COLLECTION

The concept of trust has historically been disregarded under French law, and France has never ratified the *Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition* (the Hague Convention), unlike neighbouring Italy, Monaco and Switzerland.

Yet, over the past few decades, and in line with a global movement in wealth management towards internationalisation and use of foreign legal instruments, French jurisdictions have been faced with an increasing number of French national or resident settlors, beneficiaries and even trustees of foreign trusts – and trust funds constituted, at least partially, with French assets. France's cultural opposition to trusts has, therefore, been confronted to a principle of reality, which led, from

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a tax standpoint, to trusts' recognition in the *4th Amended Finance Act 2011*[4] (the 2011 Act).

PRINCIPLES OF THE 2011 ACT WITH REGARD TO TRUSTS

In a nutshell, the driving principle of the 2011 Act is that foreign trusts are transparent entities for tax purposes, and are, therefore, subject to gift and inheritance tax, as well as wealth tax. This affects any French-resident settlor or beneficiary, and, more widely, any trust holding French assets. It covers every form of trust, whether revocable, irrevocable or discretionary. From that standpoint, trusts are formally received under French law, and defined as 'the entirety of legal relationships created pursuant to the law of a state other than France by a person that has the quality of a settlor, by means of an *inter vivos* or upon-death deed, purporting the transfer of rights or assets, under the control of an administrator, for the benefit of one or several beneficiaries or for a specific purpose'.[5]

The 2011 Act has been widely discussed, and we refer the reader to the numerous articles on the matter for a more detailed description.[6] We will only note that, as French tax authorities are highly creative when taxation principle and tax collection are at stake, it did not come as a complete surprise that the first legal recognition of trusts in France resulted from a finance act.

Still, even from a tax standpoint, the 2011 Act and its intended consequences have undergone many vicissitudes related, in particular, to the creation of a public registry of trusts, which has recently been declared unconstitutional,[7] constituting a disproportionate infringement of the right to privacy. Recently, a new registry of trusts has been introduced, with access restricted to institutions and professionals subject to anti-money laundering regulation in France.[8]

UPCOMING RECOGNITION OF TRUSTS IN FRENCH CIVIL LAW

From a civil standpoint, absent specific French legislation and the ratification of the Hague Convention, French courts have been forced to compensate for the lack of legal recognition of trusts by adapting them to existing French legal instruments. In doing so, French judges have traditionally applied an 'adaptation' or 'assimilation' method to give certain effects to foreign trusts in France.

As one author put it: 'The courts generally refrain from an overall apprehension of the instrument... they retain the distinctive feature of the relevant trust and then transpose the instrument... [so that] very few decisions refuse to recognise in France the effects of trusts constituted abroad. There are also few decisions that recognise trusts as such, and their peculiarities in relation to the assets (legal ownership; equitable ownership), as well as to the persons.'[9]

An example of application of the adaptation method may be found in a decision rendered by the Paris Court of Appeal in 1970: a French-resident settlor transferred securities to an American insurance company as trustee by executing a trust deed before the American consul in Paris, the beneficiaries being the settlor during her lifetime (interests only) and, upon her passing, various family members (principal being distributed).[10] One of her non-protected legatees challenged the very existence of the trust and requested its nullity, arguing that the applicable French inheritance law ignored the trust as a legal instrument. The Paris Court of

4 *Loi de finances rectificative*
5 *Code général des Impôts – D n ° 2016-567, 10 mai 2016*, article 792-0 bis
6 François Fruleux, '*La très confuse réforme de la fiscalité du patrimoine*', *La Semaine Juridique Notariale et Immobilière*, n° 37, 1242 (16 septembre 2011); Jean-Pierre Le Gall, '*Le nouveau régime fiscal français des trusts: une copie à revoir*', *La Semaine Juridique Entreprise et Affaires*, n° 2, 1042 (12 janvier 2012); Patrick Delas, '*Le nouveau régime d'imposition et de déclaration des trusts (et quelques réflexions d'un praticien franco-britannique)*', *La revue fiscale du patrimoine*, n° 12, étude 13 décembre 2012
7 Conseil constitutionnel, *Décision n° 2016-591 QPC du 21 octobre 2016*
8 *Ordonnance n° 2016-1635 du 1er décembre 2016 – JORF n°0280 du 2 décembre 2016 texte n° 14*
9 Jean-Paul Béraudo, Rép international Dalloz, V Trust (septembre 2012)
10 Cour d'appel de Paris, *Courtois c/Cts de Ganay* (10 janvier 1970)

Appeal ruled that the trust was to be treated as a sort of 'synallagmatic'[11] contract, which did not 'depend on the law of succession, but on the law of autonomy'. In doing so, the Court qualified the trust instrument as a mere agreement in order to incidentally recognise its legal effects.[12]

A second step in the process of recognition of trusts by French jurisdictions consisted of departing from the original adaptation method towards the recognition of the trust instrument per se, but without assimilating it to a French legal instrument. For instance, in a decision rendered on 11 March 2005, the Paris Court of Appeal ruled that a trustee could take legal action, in his own name, in a debt-collection claim against a guarantor without disclosing the identity of the beneficiaries of the trust, thus recognising the existence of the trust and the powers of the trustee.[13] Further, on 13 September 2011, the Commercial Chamber of the Court of Cassation rendered the landmark *Belvédère* decision,[14] recognising 'implicitly but necessarily the trust as such, without requalifying it as a mandate agreement'.[15]

The appellate judges went even further in the aforementioned decision, as the appellants argued that: 'The trust creates a dismemberment of ownership between legal ownership (held by the trustee) and beneficial ownership (held by the beneficiary of the trust), the beneficiary therefore benefiting from an existing right over the [trust] assets, thereby limiting the legal owner's rights of disposition.' By doing so, the appellants provided an opportunity for the Paris Court of Appeal to state that: 'The spouses J, in their capacities as trustor, trustees and beneficiaries of the trust... were rightfully entitled to contribute the immovable property to the [real estate company], although the property had been previously contributed to the trust.'

Interestingly, the Paris Court of Appeal reached an identical solution to the one provided by the Hague Convention – an act of faith?

11 In civil-law systems, a synallagmatic contract is a contract in which each party is bound to provide something to the other party. Its name is derived from the Ancient Greek *συνάλλαγμα (synallagma)*, meaning 'mutual agreement'
12 *Ibid*
13 Rev crit DIP 2005, p627, note E Fohrer
14 Cass com, 13 sept 2011, n° 10-25.533, FS-P+B: JurisData n° 2011-018623; JCP E 2011, act 484; D 2011, p2272, obs A Lienhard
15 Reinhard Dammann, '*L'arrêt Belvédère: la réception du Trust et de la Parallel Debt en droit français*', *La Semaine Juridique Entreprise et Affaire*, n°46, 1803 (17 novembre 2011)

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INTERNATIONAL PUBLIC ORDER IN THE CONTEXT OF CROSS-BORDER SUCCESSIONS: A WEAKENING FORCED HEIRSHIP

One of the main obstacles to the recognition of trusts per se by French jurisdictions is the existence of forced heirship, as trust instruments are perceived as tools allowing escape from French-law imperative provisions. Indeed, many, if not most, trust cases brought before French courts are related to successions and involve forced heirship.

The aforementioned judgment constitutes a breakthrough in that regard and may well be a milestone representing fundamental change in French inheritance law.

FORCED HEIRSHIP AND FRENCH INTERNATIONAL PUBLIC ORDER[16]

Forced heirship is one of the oldest and deepest-rooted pillars of French inheritance law. However, it is progressively weakening. The concept of forced heirship is widely shared in civil-law jurisdictions, but is generally unknown to common-law jurisdictions. The main contribution of the Paris Court of Appeal's judgment of 11 May 2016 is to illustrate this contradiction with a perfectly substantiated solution.

First, the Court ruled that a French national testator who is a Californian domiciliary at death may ignore the French forced-heirship rules, including in the presence of French children. The freedom of the testator thus takes precedence over the protection awarded to his issue as 'protected

16 The following discussion is an excerpt from Patrice Bonduelle, Geoffroy Michaux and Jérémy Leforestier, '*Un arrêt riche d'enseignements*', *La Semaine Juridique Notariale et Immobilière*, n°38, 1280 (23 septembre 2016)

heirs', at least in the international order, if not in a purely domestic situation. The Court's position, long awaited by some of the most authoritative French specialists, confirms the gradual weakening of the forced-heirship rules under French law.

REPEAL OF THE COLLECTING RIGHT

The Paris Court of Appeal also restated that the heirs' 'collecting right', which effectively opened up the possibility to disregard the normal execution of the conflict-of-laws rule attributing the settlement of the succession to a foreign law, has been repealed by France's highest jurisdiction.[17] This paved the way for a decision on the absence of protection of forced heirship under international public order. The Court specified that there is no exception to this repeal, in particular where the demise of the deceased occurred before this judgment.

THE FORCED-HEIRSHIP RULE IS NOT A FUNDAMENTAL PRINCIPLE OF FRENCH INTERNATIONAL PUBLIC ORDER

The aforementioned decision confirms that, although forced-heirship rules undeniably form part of French domestic public order, they are not afforded the protection of French international public order; the Paris Court of Appeal could have ruled differently, based on the merits of the case, by relying on the principle of proximity.

Indeed, despite the close ties with France in the case (the nationality of the deceased and his heirs, the location of the property), the Court unequivocally affirmed that, although forced heirship 'is an ancient, but also... current and important principle... in [French] domestic law, it does not constitute an essential principle... which would require protection of French international public order from the application of foreign provisions ignoring it'.

EVOLUTION OF THE CONCEPT OF INTERNATIONAL PUBLIC ORDER

The evolution from a traditional view of international public order, based on a 'universal justice' principle,[18] towards a more limited and less 'imperialist' concept of protection of 'essential principles of the French law'[19] is confirmed. The scope of international public order thus continues to be reduced. In this case, the principle of effectiveness takes precedence over declarations of principles.

This decision is not completely new; the Paris Court of Appeal had already determined, in the more restricted framework of an *exequatur* procedure, that the forced-heirship rule was not a public order principle.[20] However, it confirms a trend and contributes to settling an old doctrinal controversy with regard to the freedom of the testator, rather than the protection of their legal heirs.[21]

Finally, it should be noted that this decision was rendered after the enactment of the EU Succession Regulation, but prior to its entry into force. With this in mind, and considering that article 35 of the EU Succession Regulation provides that 'the application of a provision of the law of any State specified by this Regulation may be refused only if such application is manifestly incompatible with the public policy (*ordre public*) of the forum', the Court's ruling, although rendered in application of conflict-of-laws rules that no longer apply after the entry into force of the EU Succession Regulation, has lifted a significant hindrance regarding its effectiveness.[22]

CORPORATE STRUCTURES CIRCUMVENTING THE LAW OF THE *SITUS* OF PROPERTIES

From that standpoint, the EU Succession Regulation's guiding principle is that a succession is settled according to one unique law, that of the deceased's last habitual residence, but gives an option to the testator to subject their succession to their national law, thereby permitting citizens of countries whose laws ignore the forced-heirship rule to elude its application by expressly opting for their national law.[23] Yet succession cases remain where different laws will apply to movable and immovable assets. This was the case prior to the entry into force of the EU Succession Regulation in jurisdictions, such as France, where the devolution

17 Conseil constitutionnel, *Décision n° 2011-159 QPC du 5 août 2011*
18 Cass 1ère Civ, 25 mai 1948, Lautour
19 Cass 1ère Civ, 8 juil 2010, n° 08-21.740: JurisData n° 2010-011438, JCP N 2011, n° 14-15, 1122, note J Massip
20 Cour d'appel de Paris, 3 novembre 1987: JDI 1990 P 109, note J Heron
21 In favour of the forced-heirship rule: Michel Grimaldi, '*Brèves réflexions sur l'ordre public et la réserve héréditaire*', *Defrénois* (2012), p755, n° 7 – *contra JCl Civil Code*, articles 718 to 892, fasc 30, No 62, *par* Mariel Revillard
22 This solution is similar to the one provided in the initial draft *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* of 14 October 2009, which provided (under article 27) that: 'Public order may not be opposed to the inheritance law on the sole ground that its modalities regarding the forced-heirship rule are different from those in force in the relevant domestic legislation'
23 Patrick-Léon Lotthé and Juliette Gordin, '*Succession d'un anglais, les consequences de la professio juris*', JCP N 2015, n° 41, 1181, n° 3

of movable assets was subject to the law of the deceased's last residence, while real estate assets were subject to the law of their *situs*.

This would apply, for example, to the succession of an immovable property in France belonging to a French national residing in a 'third State' within the meaning of the EU Succession Regulation. If the law of that state, though designated by the EU Succession Regulation, denies its applicability and refers back to the law of the *situs* of the immovable property as envisaged and permitted by article 34 of the EU Succession Regulation (*renvoi* to the law of a Member State), the French law will apply to the devolution of this immovable property. The *renvoi* to the French law (and to the forced-heirship rule) may, therefore, be barred by contributing such property to a *société civile immobilière*[24] (SCI), thus giving rise to challenges based on fraud to the applicable law.[25]

For instance, someone who is both a French national and a New York resident, when informed of the *renvoi* mechanism, may be tempted to convert their property in Antibes into a movable asset, thus removing it from the scope of the French law. As a result, the law of his country of residency will apply to the shares of his SCI, which the protected heirs will seek to challenge.

In the aforementioned case, the protected heirs argued, as they could do under the EU Succession Regulation in a hypothesis of a *renvoi* (as in the example above), that a real estate asset located in France, contributed to a French SCI, was still subject to French inheritance law, based on the following three arguments.

FRAUD TO THE APPLICABLE LAW

The protected heirs first argued that: 'The incorporation of the SCI... and the contribution of the Paris property reveals a fraudulent intent to manipulate the conflict-of-laws rule with the purpose of excluding the application of the French [substantial] law.' They also argued that: 'The legal structuring surrounding the incorporation of the SCI reveals that the set-up of the SCI pursues the conversion of real estate into a movable asset as sole purpose of the SCI, i.e. exclusively motivated by succession planning purposes.'

'The protected heirs argued that a real estate asset located in France, contributed to a French SCI, was still subject to French inheritance law'

By doing so, they explicitly relied, almost word for word, on an already old decision in a similar situation.[26] A fraud to the applicable law under international law principles traditionally consists of 'on the one hand, the artificial application of a conflict-of-laws rule and, on the other hand, a fraudulent intention'.[27]

The material element 'consists of the alteration of the connection factor (*facteur de rattachement*) or the manipulation of the connection category (*catégorie de rattachement*)',[28] which, in the present case is the conversion of the property into a movable asset. This aspect does not require much comment.

The intentional element, on the contrary, is at the heart of the subject: was the future deceased aware of the effects of this legal conversion? Did he seek it as his main objective? In the *Caron* case,[29] it was clear from 'the deceased's will that the transaction was intended to enable the deceased to disinherit his children'[30] and that it (the series of harmonised transactions) was carried out 'in order' to set aside the French law: 'The act is tainted with fraud, as the non-application of imperative provisions was not merely a consequence of a modification of the situation, but its very purpose.'[31]

If evidence is provided of the awareness of the impact of the transaction on the succession, and of the clear will of the future deceased to seek such impact, the fraud will be obvious, and will constitute a ground to require the application of the French law.

24 Real estate company
25 *Contra* Michel Farge, '*Réglement successions: les nouveaux réflexes à acquérir*', JCP N 2015, n° 31, 1143, n° 33 – Louis Perreau-Saussine, '*Sociétés civiles immobilières: aspects de droit international privé*', JCP N 2013, n° 47, 1273, n° 33
26 Cass 1ere Civ, 20 mars 1985, Caron, n° 82-15.033: JurisData n° 1985-701544, Bull civ I, No 103, Rev crit DIP 1986, p66
27 *JCl Civil Code*, article 3, fasc, n° 7, par B Audit
28 Eric Fongaro, '*La loi applicable à la réserve héréditaire*', *La Semaine Juridique Notariale et Immobilière*, n°46, 13 novembre 2009, 1310
29 Cass 1ere Civ, 20 mars 1985, *Caron*, n° 82-15.033
30 Fongaro, '*La loi applicable à la réserve héréditaire*'
31 *JCl Civil Code*, article 3, fasc 50, n° 11, par B. Audit

However, as Mariel Revillard indicates: 'The contribution or sale of an immovable property located in France to a civil company or to a foreign company cannot in itself be presumed fraudulent [this wording was used by the Paris Court of Appeal in the aforementioned judgment]... when the parties and their heirs seek to solve, in a fairer manner, several economic, family or tax issues.'[32] This argument was reformulated by the Paris Court of Appeal, which raised the 'tax, economic or commercial reasons'.

In other words, if the purpose is not exclusively to modify the law applicable to the succession, and if a different motivation can be demonstrated, the contribution or the sale to the SCI cannot be challenged.

In particular, if it can be argued that the contribution allows 'the deceased to legitimately avoid the mischiefs of fragmentation'[33] for an asset of low value at the level of the global heritage, and if the parties demonstrate other motivations, the operation will not be open to challenge.

From that standpoint, it should be noted that the EU Succession Regulation contemplates the possibility of such remedies in recital 26: 'Nothing in this Regulation should prevent a court from applying mechanisms designed to tackle the evasion of the law, such as "*fraude à la loi*" in the context of private international law.'

THE FICTIVENESS OF THE OPERATION

The Paris Court of Appeal did not discuss the fictiveness of the contribution to the legal entity, which would have been an interesting angle for challenge. Was the transaction simulated or artificial? Was it carried out by a person who, in fact, remained the sole beneficiary of the contributed property, thus lacking any *affectio societatis* with his 'nominee' partner; with no company accounts and reporting to nobody; using the contributed asset as his own, and, therefore, maintaining a complete confusion of assets? These criteria may have allowed the Court to qualify the company as fictitious.[34]

THE NON-DOMINO CONTRIBUTION

The protected heirs have pointed out an additional difficulty: the contribution of the immovable property to the civil company had been preceded by a transfer to a trust. The protected heirs argued that the contribution was void, as it had been carried out by a person who was no longer able to dispose of it. The Paris Court of Appeal rejected this argument. On the one hand, it considered that, as far as the act of contribution to the trust had not been registered in France, the property had not left the estate of the contributor 'in accordance with French law'. On the other hand, it considered that, in their capacity as 'settlors,[35] trustees and beneficiaries in the event of the demise of one of them', the future deceased and his wife had full power to make the contribution to the SCI, even if that asset had previously been contributed to the trust. The contribution is valid if the trust is neglected, and if it is recognised, as the trustees have the right to dispose of the assets in accordance with the law of the trust.

The Paris Court of Appeal could not state more clearly that foreign trusts are valid and will produce their effects in France if constituted in conformity with the law applicable in their jurisdiction of origin; and that forced-heirship rules will not defeat a contribution made to that trust, provided that the contribution was not solely based on fraudulent motives.

The reader will, therefore, look forward to knowing whether and to what extent the Court of Cassation will follow the Paris Court of Appeal in its 'internationalist' inclinations.

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32 *Droit international privé et communautaire: pratique notariale*, 8th edition, *Defrénois* (2014), p420
33 Yves Lequette, '*Ensemble législatif et droit international privé des successions*', Travaux Comité français DIP, 1983–1984, p170
34 JurisClasseur, *Sociétés Traité*, fasc 7–40, *par* A Martin-Serf
35 'Trustors' according to the court