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Discretionary trusts under the new French trust régime: initial thoughts.

 Monday, 16th January, 2012

The *loi de finances rectificative pour 2011* in its article 14 has attempted to correlate French fiduciary notions in relation to foreign concepts. In doing so, it has rendered any attempt to give legal certainty to clients a theoretical impossibility. This is no more than an initial set of thoughts as to how this attempt can be turned against its perpetrators, who frankly deserve no mercy or quarter and probably expect neither.

The fundamental issue remains: how does the civil lawyer apprehend an interest in a trust.

Here, whilst the terms beneficial right and beneficial entitlement are treated by common lawyers in varying degrees as a property matter, it cannot be apprehended as such under a Roman law based unitary system of property law, because they do not have the essential ingredients of property. Does one convey a beneficial interest as a self-standing right, or does one rather secure an agreement as to future action or inaction from the trustee, the beneficiary and the 'purchaser'. Whilst that might sound a familiar option to Roman law scholars speculating on modern day forms of manumission, it simply does not assimilate to any form of conveyance of a real right under civil law. Hence the lop-sided and legally ineffective drafting of article 792-0 bis. The tax code cannot constitutionally accommodate a definition of a property law instrument.

Putting the matter in its context: in March 2010, the French Parliament passed an amendment to the Code Civil by which a contractual fiduciary arrangement known as a *fiducie* was introduced.

As a contractual and by definition not a gratuitous transfer, this is not and never will be a trust which depends upon a transfer of property subject to "trust". In other words a trust operates on the conscience of the person owning the property, not just on his wallet. A *fiducie* is little more than a form of contractual security mechanism. Contrary to certain initially optimistic

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affirmations from certain law firms in London, a *fiducie* is simply useless as an estate planning technique in France. It is no more than a form of security device, and is devoid of real fiscal interest in that area. It can be used in the area for which it was intended, that of security interests.

However it does leave a form of statutory precedent which when compared to the tax definition of a "trust" can give impetus to criticism and also, possibly, to some form of softening of the impact of the 2011 trust legislation.

Of particular interest is the use of the *faux ami*, the term *bénéficiaire*. Let me start by proposing that it is a falsehood to assume that this equates to the term beneficiary as it is understood in Equity. That would be a grave error. It cannot be; as the term has no existence in French law, it has to refer to an existing concept of the civil law. The closest one on the statute book is the term *bénéficiaire* in the law introducing the *fiducie*, or in the insurance area, where, in both cases it refers to a form of third party contractual entitlement. Hardly an equitable right of property to be confused with remedies of tracing, which a certain Law faculty in the South of France has chosen to assert in an unsigned and unnamed dissertation to be part of the law of trusts, and, unless struck out as inaccurate and misleading, will doubtless be cited as authoritative by the administration: careful what you teach.

Code Civil	Hague Convention 1985 (NOT Ratified by France)	Code General des Impôts
Article 2011 *La fiducie est l'opération par laquelle un ou plusieurs constituants transfèrent des biens, des droits ou des sûretés, ou un ensemble de biens, de droits ou de sûretés, présents ou futurs, à un ou plusieurs fiduciaires*	*Article 2* *Aux fins de la présente Convention, le terme « trust » vise les relations juridiques créées par une personne, le constituant - par acte entre vifs ou à cause de mort - lorsque des biens ont été*	*Article 792-0* *I. — 1. Pour l'application du présent code, on entend par trust l'ensemble des relations juridiques créées dans le droit d'un État autre que la France par une personne qui a la qualité de constituant, par acte entre vifs ou à*

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qui, les tenant séparés de leur patrimoine propre, agissent dans un but déterminé au profit d'un ou plusieurs bénéficiaires. *NOTA:* *Loi 2007-211 du 19 février 2007 art. 12 : les éléments d'actif et de passif transférés dans le cadre de l'opération mentionnée à l'article 2011 forment un patrimoine d'affectation. Les opérations affectant ce dernier font l'objet d'une comptabilité autonome chez le fiduciaire.*	*placés sous le contrôle d'un trustee dans l'intérêt d'un bénéficiaire ou dans un but déterminé.* *Le trust présente les caractéristiques suivantes :* *a) les biens du trust constituent une masse distincte et ne font pas partie du patrimoine du trustee ;* *b) le titre relatif aux biens du trust est établi au nom du trustee ou d'une autre personne pour le compte du trustee ;* *c) le trustee est investi du pouvoir et chargé de l'obligation, dont il doit rendre compte, d'administrer, de gérer ou de disposer des biens selon les termes du trust et les règles particulières imposées au trustee par la loi.* *Le fait que le constituant conserve certaines prérogatives ou que le trustee possède certains droits en qualité de bénéficiaire ne s'oppose pas nécessairement à l'existence d'un trust.*	*cause de mort, en vue d'y placer des biens ou droits, sous le contrôle d'un administrateur, dans l'intérêt d'un ou de plusieurs bénéficiaires ou pour la réalisation d'un objectif déterminé.* *2. Pour l'application du présent titre, on entend par constituant du trust soit la personne physique qui l'a constitué, soit, lorsqu'il a été constitué par une personne physique agissant à titre professionnel ou par une personne morale, la personne physique qui y a placé des biens et droits.*
Article 2012 *La fiducie est établie par la loi ou par contrat. Elle doit être expresse.*	*Article 3* *La Convention ne s'applique qu'aux trusts créés volontairement et dont la preuve*	

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Si les biens, droits ou sûretés transférés dans le patrimoine fiduciaire dépendent de la communauté existant entre les époux ou d'une indivision, le contrat de fiducie est établi par acte notarié à peine de nullité.	*est apportée par écrit.*	

The differences between these three concepts are substantial, but the attempt to deploy civilian conceptualisation to a foreign concept does render the dissimilarities all the more striking.

The fiducie	Hague "definition"	Ze "trust"
Either constituted by law, or by contract, but not gratuitously.		Has to be constituted by an "*acte entre vifs*", in other words inter vivos in writing, or by a will "*acte .... à cause de mort*". Therefore "gratuitous".
… l'opération par laquelle un ou plusieurs constituants transfèrent des biens, des droits ou des sûretés, ou un ensemble de biens, de droits ou de sûretés, présents ou futurs	*… créées par une personne, le constituant* ;	*…. créées dans le droit d'un État autre que la France par une personne qui a la qualité de constituant…* How is the term « *qualité* » defined? If by reference to the law of the "trust", how therefore can a transfer of the mere power of administration constitute a "trust" under the three

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		certainties?
Contract; « … *un ensemble de biens, de droits ou de sûretés, présents ou futurs*… » a set of assets, rights or charges. This in fact created the notion of a separate estate over a mass of assets, which until this change was anathema to the civil law of property in France. However, this is not correlated to the set of legal relationships – not assets- referred to in article 792-0 bis.	« *les relations juridiques* » not the set of legal relationships to which the French text refers	If it is not a reference to the term used in art. 2011 Code civ then the notion of "*ensemble de relations juridiques*" is taken from a criticised and abandoned French proposal in the very initial *travaux préparatoires* on the Hague Convention of 1985 on the recognition of trusts and has no Treaty authority. The Convention, and therefore its preliminary drafting were not ratified by the French government. Neither does the definition correspond to the definitions of a "trust" used in the EU regulations and conventions involving trusts. Reference to the law of a State or territory other than France coupled with that of an "*ensemble des relations juridiques*", means that

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		the French administration loses juridical competence over the interpretation, and is required to refer to that law.
« *Fiduciaires* »: the fiduciary acts under contract, and is therefore acting under a degree of heightened contractual responsibility within a given objective to the *bénéficiaire*: in other words the individual with a continuing fiduciary interest in the assets throughout the *fiducie*.	*c)* le *trustee* est investi du pouvoir et chargé de l'obligation, dont il doit rendre compte, d'administrer, de gérer ou de disposer des biens selon les termes du trust et les règles particulières imposées au *trustee* par la loi.	« *Administrateur* » : not *fiduciaire*. There is no fiduciary duty referred to here, merely a reference to administration of a right or asset. The transfer of full ownership to the trustee required under trust is not caught by this wording which does not include the right of management, "*gestion*", and that of disposal, or "*abusus*". Again "cherry picking" in one of the attributions of a Trustee enabling legal recognition as of right under the Hague Convention, but insufficient to ground a trust.
The beneficiary here has a contractual right to have the property returned to him. He therefore retains a right of		« ….*dans l'intérêt d'un ou de plusieurs bénéficiaires*.. » The concept is apparently identical to that of a *fiducie*,

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disposal at some point in the contract.		however, that would imply that the beneficiary has some right or call over the property. In a discretionary trust, that may not be the case.
	No definition of a settlor or « *constituant* », which would enable the re- attachment of the fiscal estate created under article 792-0 bis.	No actual express creation of a *patrimoine d'affectation*, held for the settlor, but the logic of the fiscal structure requires it.
The *fiduciaire* has the power of disposal	le *trustee* est investi du pouvoir et chargé de l'obligation, dont il doit rendre compte, d'administrer, de gérer ou de disposer des biens selon les termes du trust et les règles particulières imposées au *trustee* par la loi.	The *administrateur* merely has the power to "administrate". He neither has a power to "manage", in other words exercise a fiduciary responsibility, nor of disposal i.e. the fundamental right of ownership required by the civil law, but not by the tax law.

The main point arising from these comparisons is the manner in which the French administration in its alternative definition has chosen to, and in some cases has been forced to cherry pick from various aspects of the Hague Convention's recognition criteria - they are no more than that - and has been forced to abandon certain others. For example, its 792-0 bis

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definition refers only to a power to administer the assets, it does not refer to the power to manage or alienate the assets. It therefore omits one of the essential parts of the function of a trustee which is to manage and what is more dispose of the property as an owner. That is his "trust" and why the property has been entrusted to him by transfer and his acceptance. If a person does not have the right of "*abusus*", or disposal, he is not the owner under civil law, he can only be an administrator, and therefore can only act under a limited mandate. An *administrateur* has to ask permission and have an act of management or disposal ratified, if not actually performed by the owner. It is less than a mandate. That is what renders the application of article 792-0 bis to a discretionary trust inappropriate and therefore wrong. By extension it can also call into doubt the inclusion of other forms of trusts with a significant management and dispositive responsibility placed upon the trustee.

It is therefore arguable that a discretionary trust in its purest sense does not by its nature and therefore by definition fall within the restricted definition of article 792-0 bis. The effect of this is not academic. If a member of a beneficial class of a discretionary trust resident in France has no vested "right" then how can he be legitimately charged to tax as a "beneficiary", which must imply some correlation with the term in article 2011, and that as if he did have a proprietary right rather than a mere hope? One may live in France in *spes*; perhaps. The current issues with the principle in *Saunders v Vautier*, where it is practically impossible to assemble the entire beneficial class, minors and unborn included, to a discretionary trust fund in agreement to call for the assets and its termination are potentially useful here.

The Hague Convention was never intended to provide a definition of a trust. Its intention was to restrict itself to defining certain criteria for recognition which, if present, required recognition by the State concerned.

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It is impossible to find two judges with the same definition, let alone two - living- academics.

The point has to be raised, it is clearly dishonest of a State which has abstained from recognising a Convention, and therefore be bound by its negotiated intendment to then cherry pick as it pleases in constituting a different definition of what is a trust for its own fiscal purposes, without taking the responsibilities involved in ratifying it. The French administration has chosen to abuse the concept by in fact transforming it into something lesser than it is.

Had the full terms of the Convention's recognition criteria been incorporated, and remember, they are no more than that - *d'administrer, de gérer ou de disposer des biens*- or rights, the consequence would have been that the French fiscal estate created could not have been reserved to the settlor alone. Why? Because, barring retained or reserved powers, the Settlor has no right to manage or dispose of the trust fund, and therefore has no ownership rights upon which an assessment of wealth could be fixed. *A contrario*, that in itself raises the issue of whether the taxation of a beneficiary resident in France on what is in fact the deemed estate of a foreign person can be conceptually justified. Where is his contractual third party entitlement, as a *bénéficiaire* ? To my mind, a beneficiary resident in France can only be legitimately taxed in fact when that person has a vested or appointed interest or right, and not on the basis of a mere hope, as yet unfulfilled. To that extent, the jurisprudence in *Poillot* may remain unaffected. That point will need to be raised in an appeal against the inevitable penalty which will be inflicted upon a French resident member of a beneficial class under a foreign discretionary trust, where the settlor is non-resident.

The French administration's draftsmen are not lawyers. Had they been, no such addled a definition would have been proposed. The Chancellerie, despite being invited to do so, has abstained from comment upon the drafting as being outside its constitutional competence. A Trustee is simply not a mere administrator, and the definition is therefore defective, as it cannot

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include what is in effect the owner "at law" of the rights or assets concerned; a fundamental issue as to the creation of a trust under the foreign law concerned and to which reference is made in the statute. A trust over the full ownership of a right or asset can certainly not be constituted merely by the transfer of a mere power of its administration. Whilst one can be trustee of a power, that does not render one trustee of the assets themselves.

What is more, the fact that the authoritative text of Hague Convention Treaty is expressed to be in French and English at the final paragraph can hardly render the definition authoritative when France, and therefore the French tax administration, has not deigned to ratify its signature. Perhaps it will never be, as, if it were, the dismembered attempt at a definition at article 792-0 bis would fall legless at the first hurdle.

Remember that a fundamental human right is not to be "expropriated": there is a fiscal exception to this, but it is no more than an exception. The French trust assessment system comes very close to a breach of this right, in that the fiscal legislation in effect "creates" a non-existent property right in a deemed mass of assets, and then requires a person who is technically not interested in it to pay the tax assessed out of their own property.

HMRC, bless them, started all this off with a settlor based assessment in the 1990s, rather than an asset and owner based assessment. It is curious how illusion takes over as a moralisation of reality in matters of taxation by a foreign Treasury impelled by its financial services industry.

Unfortunately for the French draftsman at the *Ministère de finances*, the area of private international law into which they have had to venture may not be as hospitable a territory as they imagined. The strategy adopted in the drafting was to approach the tax structure imposed as closely as possible to that of a life insurance policy, hence the makeshift *prélèvement* collection mechanism as yet undefined.

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In practice, many trustees will seek to take avoiding action rather than to address this issue in front of the French tribunals. The post-Christmas sales of French government bonds and account changes from foreign branches of French banks may in fact pour some cold water, albeit temporary upon the French treasury. However, that will not address the future position of members of a discretionary class moving to France for professional reasons or for retirement, whose lives have been rendered unnecessarily complicated by the perhaps ill-advised questioning of the administration by a Paris firm. The Rescrit published on 29th December, 2011, albeit dated 23rd , may have cleared any residual question of whether corporate trusts were within the scope of the legislation - it is curious that a legal opinion on that could not be given without consulting the Fisc - however, the French administration were unlikely to be drawn into admitting that their definition does not catch 'unvested' members of a discretionary beneficial class by such a request. Any doctrinal change in the administration's position in relation to the law, as iterated at unappealed first instance, by the TGI Nanterre in the 2004 Poillot decision, has yet to be clarified.

I stress that these are general thoughts, and would iterate that no action should be taken merely on the basis of these ideas alone. Whilst perhaps a call to stand firm, as to concept, it is not advice or opinion, and professional advice should be taken as to specific cases, as each will turn on its factual situation. Such, after all, is the law of trusts, the law of equity and the law of property. Were these contractual law or common law, then perhaps the French might have had a better hope of success. Unfortunately, the observer might feel that it is now down to ignorant administrative "bullying" to which the only civic antidote is legal advice and advised action.

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