Forced Heirship in Foundations and Trusts

Dr Max Ganado, December 2011

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The clash between a person’s right at law to settle property into trust or endow property to foundations, as a legitimate manifestation of their rights as owner, and the effects of forced heirship rules on this right (or freedom) in a given country is a matter which raises much debate in legal circles.

Unfortunately, this clash is often wrongly perceived as a reflection of a hostile approach civil law systems traditionally adopt towards trusts. This clash has been present in civil law systems since time immemorial and applies indiscriminately to any gratuitous transfers, not just settlements under trusts or foundations. There are rules of predictable application to resolve the conflict in a just manner.

It is very important for any practitioner in the estate planning practice area to be aware of how these rules operate within a given legal system so as to properly advise a client to whom these rules apply, usually persons domiciled in legitim jurisdictions. Malta is classified as such, but is one which has trusts and foundations embedded into its Civil Code and is now operating in the normal course of social relationships. It is therefore an ideal candidate around which this kind of discussion can take place, throwing light on how the issues are regulated in other civil law systems.

Terminology

Despite there being various terms used in this area of law across various jurisdictions, they usually possess the same meaning and are used interchangeably in this contribution. Forced heirship under Maltese law includes the reserved portion for heirs, which is a right of credit vested in the descendants affecting the non-disposable portion of the estate.

Various civil law jurisdictions have such rules. For example, Italy has successione necessaria while in France they bear the name of legitime. While different jurisdictions might have different words to refer to forced heirship rules, the same basic concept is common to all jurisdictions, with maybe different emphasis on the legal effects of these rules. Some see it as a credit against the estate, some as a share in each part of the estate, some as a lack of capacity of the parent or spouse to dispose of part of his or her estate. The proportions of the claim to the estate and the assets over which it can be claimed also vary in different countries. Intrinsically, it is always a right by defined persons related to the decujus (deceased) against an estate which can be claimed and enforced against all heirs or legatees and against all assets, and with some retrospection.

Malta will be used to illustrate how the interaction between trusts, foundations and succession rights occurs in civil law systems.

The reserved portion
The deceased’s children and/or widow/widower (the legitimaries) have a right at law against the estate, that is, the reserved portion. This right translates to a right of credit against the deceased’s estate, equal to the value of the legitimate’s share at law over that estate. This share varies according to the circumstances.

**Calculation of the estate value**

Prior to the exercise of any remedy based on forced heirship rules, the entire estate must be calculated. The estate is divided into two portions: the disposable portion, which can be freely disposed of, and the non-disposable portion, reflecting the value of the legitimaries’ rights over the estate. Some basic rules must be followed:

- all the property of the deceased, whether movable or immovable, existing at the time of their demise must be valued
- any liabilities burdening the estate are deducted from that result, and
- any property transferred gratuitously during the lifetime of the deceased is fictitiously added back with its value being reckoned at the time of the donation.

The non-disposable portion and any other rights to which the surviving spouse is entitled are then computed. As settlements and endowments of property are gratuitous, these are to be calculated with all other gratuitous transfers.

**Conflicts of Laws**

A preliminary hurdle is to determine when the reserved portion applies, and its effect on any settlements and endowments made. Traditionally, British private international law rules have been applied by Malta’s courts when faced with cross-border property and succession law matters. Thus, Maltese courts opted for the system of scission, whereby immovable property is regulated by the lex situs and movable property is regulated by the lex domicilii at the time of death. In practice, the deceased’s estate is fictitiously divided into two, movables and immovables, which may well be regulated by different laws.

However, the author disagrees with this approach as being too uncertain when applied to the reserved portion, which is by nature a set of rules which can only apply to the estate as a whole, unless of course you opt to treat property in each country as a separate estate, which is even more unsatisfactory in this context. This article opts for a unitary approach for the application of legitim rules where the lex domicilii at the time of death governs the whole estate. In fact, the Trusts Law Project has sought to adopt this approach for in connection with trusts.

The Trusts and Trustees Act classified ‘succession rights, testate and intestate, especially the indefeasible shares of spouses, ascendants and descendants’, which also include rules on forced heirship, as provisions of Maltese law that may not be derogated by agreement (mandatory rules). These mandatory rules will have an overriding effect on the law governing the trust, as directed by the Hague Convention on the Law Applicable to Trusts and on their Recognition (Hague Trust Convention). By way of example, the settlor may not avoid their application by opting for the law of a non-legitim jurisdiction as the law governing the trust. However, it is imperative to note that these mandatory rules have a limited scope of application – they will only apply where the trust is governed by Maltese law and when either:

- the settlor’s domicile is Malta at the time of the settlement, or
• where any immovable property is settled into trust, that property is situated in Malta.

These mandatory rules will also apply where the trust is governed by any foreign law and the settlor’s domicile is Malta at the time of the creation of the trust.

The opposite then applies, and under Maltese law, these rules do not apply when the settlor is not domiciled in Malta or another state with a similar legal system. The rule remains stable even if the settlor subsequently becomes domiciled in Malta. Of course, this may not be the rule in France, Italy or Spain, so you have to check carefully before buying property in these countries, whether in your own name or through a trustee. Malta has solved this particular issue as many domiciliaries from common-law countries that do not have forced heirship rules come to reside in Malta and this enables them to create an element of certainty. As we are seeing in the European Union project on succession, the trend is in the same direction where the law applicable to the estate will be one, and not many, depending on where assets are located.

Legitimaries’ protection

Once it is determined that any forced heirship rules are applicable, in terms of the above choice of law rules, the forced heirship rules will not have effect unless the assets donated, disposed by will, or settled in trust by the deceased exceed the disposable portion. An important caveat is that these actions are only applied where one of the legitimaries feels their rights have been either prejudiced or put at risk and protests before the Maltese Courts or formally notifies the trustee. Thus, unless a legitimary takes action, all donations, wills, settlements and endowments will remain valid and untouched.

The legitimary is traditionally allowed two courses of action, depending on the nature of the disposition:

**Action for abatement of testamentary dispositions:**

where the property exceeding the disposable portion is disposed by will, the legitimary may exercise the action for abatement of testamentary dispositions. This action may only be exercised where the donations made by the deceased neither equal nor exceed the disposable portion and where the testamentary dispositions exceed the disposable portion. If this is the case, all testamentary dispositions, whether or not contained in different wills, are indiscriminately reduced proportionately so as not to exceed the disposable portion.

**Action for reduction of donations and settlements:**

where the property exceeding the disposable portion has been donated, or settled under trusts, the legitimary may exercise the action for reduction or recovery of such property. This action is to be exercised where the donations or settlements made by the deceased exceed the disposable portion. It is essentially a clawback mechanism – where the property gratuitously transferred in terms of law, but which exceeds the disposable portion, must be returned to the deceased’s estate free from any debt or hypothec with which it may have been charged. The reduction applies according to the order of the dates of the donations or trusts, commencing with the most recent.

Where the deceased has made both donations and settlements during their lifetime, these transactions remain subject to the legitimaries’ claims, if, when taken collectively, they exceed the disposable portion. For the purposes of determining whether a donation or a settlement is subject to
the legitimaries’ claims, they will be treated as forming part of the same type of transaction. Thus, the most recent transaction, be it a donation or a settlement, will be subject to the respective action brought by the legitimary. This rule confirms the point that when there is a reserved portion issue in an estate where trusts feature, the clash will arise in relation to a trust only if the disposable portion is exceeded and not just because it is a trust.

Where the beneficiaries to that trust settlement suffer a mental or physical disability the law provides an exemption from the action for reduction of settlements. The trustee is allowed to ask the court to order that the property not be sold, divided or reduced until the death of the said beneficiary, if in the trustee’s discretion it appears that the trust property is not susceptible of division, sale or reduction to fulfil the claims of the legitimaries.

Imputation and collation

The institutes of imputation and collation are two interesting, very similar mechanisms, typical of civil law systems. They are worth noting, being relevant in the context of legitim and trusts and foundations. Imputation obliges the legitimaries entitled to a reserved portion to take into account, when calculating their reserved portion, any gratuitous transfers made in their favour by the deceased, including any benefits from a trust or foundations. It is aimed at ensuring that nobody gets more than it is fair for them to get.

Collation similarly obliges the deceased’s descendants, being co-heirs, to take into account any gratuitous transfers so made, when calculating their share of the inheritance, which is, of course, the test to see whether their share is above or below their legitim entitlement. It is based on the presumption that the deceased did not intend to discriminate among their children and descendants.

Therefore, unless the will or the inter vivos deed provides a specific exemption, which is possible, the law imposes the obligation to impute or collate that sum, even if derived from a benefit under a trust or a foundation, to your share.

Management of conflict rules

Specific to settlements into trusts, the Civil Code and the Trusts and Trustees Act, when read together, contain some specific rules on the preservation of the trust fund. The trustee, as an administrator of the property settled in trust, is in an ideal position to appreciate all divergent interests in that property, whether they are the settlor’s, the beneficiaries’ or the legitimaries’. The trustee remains duty bound to preserve the trust, ‘as far as possible’, and to make sure that the terms of the trust comply with mandatory rules. In view of this, the Trusts and Trustees Act gives the trustee various powers:

- to vary the terms of the trust in so far as relates to the nature and extent of the benefit and to perform any acts as are necessary and legally permissible, so that settlor’s intention is respected
- unless agreed otherwise in the trust agreement, to reduce the trust assets and return all or part of them to the settlor or the estate of the settlor so as to achieve compliance with these mandatory rules
- unless agreed otherwise in the trust agreement, to enter into arbitration and mediation agreements and to reach a compromise to disputes and claims by third parties; and
unless agreed otherwise in the trust agreement, to seek directions from the court on such matters.29

Very importantly, in these cases the law expressly exempts a trustee from liability if they exercise such powers ‘in good faith and reasonably’30 or if they make distributions of trusts property ‘in good faith prior to having written notice of any claim’.31 otherwise trustees would not be motivated to take practical decisions consistent with the law and would continually refer the matter to the courts for direction.

Exclusion of foreign law application by non-legitim jurisdictions

It must be pointed out that some non-legitim jurisdictions, where there are trusts involved, have introduced rules excluding the application of any foreign law directed by their own choice of law rules which provides for mandatory succession rights, such as forced heirship rules. A prime example is the Cayman Islands.32 However, this exclusion is of limited effect, particularly for two reasons. First, the legimatory’s action against any settlements under a trust is generally a subsidiary claim to be exercised only after an action against the heirs or legatees has been brought, and where the property left to heirs and legatees has been exhausted without satisfying that claim.

Second, when the settlor is domiciled in a legitim jurisdiction they invariably have assets there, possibly even under the offshore trusts. It should be noted that the offshore law’s exclusion will not have an extended extraterritorial effect on legitim jurisdictions, which consider forced heirship rules a matter of public policy. Thus, the legitimaries may always initiate proceedings (in correct order, of course) in the settlor’s domicile and claim the application of forced heirship rules in that jurisdiction over trust assets. If assets are outside the settlor’s domicile and in other civil law countries the same rules will apply on the basis of lex situs, conflicts of law rules or comity.

All this means that only property physically inside the offshore jurisdiction will be protected. But that then means the claimant will be able to go against heirs, legitimaries and other beneficiaries of earlier donations or settlements of property to make up the loss. Would anyone want to upset their whole history as a result of a rule which keeps offshore property under an offshore trust in the offshore country (e.g. a bank account), out of the civilian logic33, which brings about a fair, logical and predictable result?

Maltese law, as the lex situs, will not apply to domiciliaries from non-legitim states having property under trusts in Malta

The Maltese legislator veered away from such a solution. Apart from disregarding the principle of comity under private international law and being a risk to interstate relations, it provides illusionary protection to the settlor. Malta, however, adopted exactly that solution to ensure that Maltese law, as the lex situs, will not apply to domiciliaries from non-legitim states having property under trusts in Malta. These domiciliaries have freedom of disposition, and there is no problem in recognising
that freedom for persons not domiciled in Malta. That is supporting the law of their domicile, not clashing with it.

**Conclusion**

Malta as a legitim jurisdiction presents itself as a good example of how a fair balance can be struck between succession rights and settlements or endowments of property made by the _deceased_; incompatibility in this area of law is merely a misconception. The framework of rules that already exist and those introduced additionally in respect of trusts and forced heirship show it is possible to have the institutes of trusts and foundations operating consistently and even constructively in a civil law system, and generally within the global estate of a relevant person: our client.

1. Malta introduced trusts in 1988 and absorbed them into the general legal system in 2004. Foundations operated by common law for centuries and have been legislated upon as an institute in 2007.
2. The surviving spouse has further rights under article 633 (right of habitation over the matrimonial home) and article 635 (right to use furniture) of the Civil Code, chapter 16 of the Laws of Malta, which are also a form of forced heirship rules.
3. Article 536 et seq, Codice Civile.
4. Article 913 et seq, Code Civil.
5. It must be noted that with the coming into force of the 2004 amendments, ascendants of the deceased are no longer entitled to the reserved portion.
6. Article 615(1) (n2).
7. Article 615(2) (n2).
8. Hence, where the widow or widower is survived by the deceased’s children, they are entitled to a quarter share; however, where this is not the case their share increases to one-third, as per articles 631 and 632 (n2). On the other hand, descendants, when fewer than four, are entitled to a one-third share to be divided among them, while if more than four, they are entitled to a one-half share divided between them, as per article 616 (n2).
9. Article 614(1), (n2).
10. Article 614(2), (n2).
11. Article 648, (n2).
12. It is acknowledged this can be controversial, and the lex situs dominance is influential even in Maltese court judgments dealing with succession, but it has the benefit of predictability and logic; and is fair on both the legitimaries and the heirs of the estate as a whole. Applying multiple estate scenarios can be enormously complex, may result in past donations not being capable of allocation to any one estate, may result in different and possibly duplicate or triplicate claims in each country, may have groups of different persons with entitlement, etc.
13. This was the project whereby trusts were introduced into the domestic legal system for general application.
14. Article 958G (n2). This ensures that the Maltese law will not apply when a person is not domiciled in Malta and places property in Malta under trusts. The article states: ‘Article 958G(1): Where movable or immovable property situated in Malta has been settled in trust, under the laws of Malta or otherwise, by a person who is not domiciled in Malta at the time of settlement:(a) such person shall be deemed to have had capacity to do so if at the time of such transfer or disposition he was of full age and sound mind under the law of his domicile and the law of Malta, and(b) no provision in this Code relating to inheritance or succession to such property including, but without prejudice to the generality of the foregoing, rights to a reserved portion or similar rights applicable under this Code shall apply to such trust property, at such time or subsequently, and (c) the beneficiaries shall be deemed to have
capacity to benefit. (2) Once property has been settled in trust it shall not be affected by a change of domicile of the settlor, even if the settlor subsequently becomes domiciled in Malta. (3) For the purposes of this article ‘reserved portion’ means the legal rule restricting the right of a person to dispose of their property during their lifetime, so as to preserve such property for distribution at his death, or having similar effect.

- 18. Article 647 et seq (n2).
- 19. Article 650 and 651 (n2).
- 20. Article 651 (n2).
- 21. Article 1813 et seq (n2).
- 22. Article 1813 (n2).
- 23. Article 1821 (n2), in specific respect to immovable property.
- 24. Article 1822 (n2).
- 25. There is some doubt, because of drafting issues, as to whether endowments of property to a foundation are also of the same type of gratuitous transactions. In the author’s view they are and so are susceptible to the same actions for reduction. There is need to establish more rules to ensure that trustees of foundations have the same tools as trustees under trusts when faced with legitim claims.
- 26. Article 958D (n2).
- 27. Article 958B(11) (n2).
- 28. Article 6B(b) (n15). Article 6B is called the ‘Management of Conflict provisions’ and is a definite contribution to the discussion because it articulates the solutions and applies them to the context of trusts, albeit taking a starting point from the basic rules which already exist relating to donations.
- 29. Article 6B(b) and (c) (n15).
- 30. Article 6B(c) (n15).
- 31. Article 6B(g) (n15).
- 32. Article 91(b), Cayman Trust Law (2009 Revision).

- See more at: http://www.step.org/forced-heirship-foundations-and-trusts#sthash.HQLBpdFi.dpuf