ESTATE PLANNING AND FAMILY CONSTITUTION: TWO FUNDAMENTALS IN A CIVIL LAW ENVIRONMENT

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ESTATE PLANNING IN A CIVIL LAW CONTEXT

Some may think there is no need to anticipate one's succession in a civil law environment, especially in France.

The civil code has indeed planned everything under the close scrutiny of the *notaires*. (This is one reason there is no proper French translation for the term "estate planning".) It is reassuring to take the view that preparation is not needed; however, it is not accurate.

The rules deriving from the civil code are intended to apply to every family, in order to protect the most vulnerable and implement relatively simple solutions.

It is not adapted to family businesses or high-net-worth individuals. This is the reason civil succession rules are part of the relative public order. It means that heirs may give up their rights as they think fit. It is a common practice in France to forgo the application of the civil code in order to favour one heir over the others, for the preservation of one of the family members or the protection of the family wealth.

On the other hand, the civil code has not adapted to the new ways of life. People travel more easily, meet new people, are exposed to cultural diversity, and change their place of residence several times during their life. Divorces are common, and blended families mean the rules established by the civil code are not always a good fit for the changes in society.

It is therefore difficult to predict the location of assets and a family member's situation at the time of their death, especially since people live longer. Family wealth is also spread over different continents. Some assets are indispensable while others are less essential to the family or the legacy of its founder.

Some heirs to a large fortune consider themselves the custodian; they are expected to maintain it and ensure that it yields a profit, and then pass it on to the next generation. However, faced with a globalised economy in constant flux, family wealth cannot be maintained forever if it is not properly structured. This situation is not new. Fortunes have always been built and lost over time. But we are now living in an environment that is ever more legally framed, where transparency is key and the punishment for tax evasion exemplary.

Moreover, splitting the decedent's fortune between the heirs is still the immutable principle. However, it contradicts the objective of perpetuation of family wealth that is sought after by most founders (or current custodians), even coming from a civil law culture.

As a consequence, it is essential to determine what the clients want to achieve, and under which fundamental

principles. Family constitution is therefore a necessity for families in a civil law environment.

Having said that, it is key to define the term "family constitution" (which is a matter for debate) before trying to highlight the ever-increasing need to resort to family constitution in a civil law context.

WHAT IS "FAMILY CONSTITUTION"?

There is no precise definition of this term. It is not simply a synonym for "family governance".

Family constitution is not a binding legal act. It is in fact a set of rules that can be more or less developed. It must, first and foremost, reflect what the founders or the current custodians of a wealth want to see in it.

The concept of family constitution seems new, but in fact we have all used it, without always being fully aware of it, as a basis of reflection to organise or reorganise a family estate; to help clients prepare their succession; or to draw up a will, a trust settlement, a letter of wishes or a shareholders' agreement in a family group.

The family constitution allows the founder to describe the context in which the family fortune was constituted. It is on this occasion that the fundamentals and family ethics are addressed and can be formalised, if need be.

The family constitution is also an opportunity to explain the factors governing an estate organisation – for example, the use of some group companies; holding companies (which can be established in some jurisdictions other than the country of residence of family members); trusts; foundations; and so on.

The founders (or current custodians) of the family wealth are often more concerned with this part of the constitution, which forms the pillars of what they have built (or have acted to preserve/consolidate).

In addition, the family constitution allows founders and stakeholders to present their vision for the passing-on and preservation of the family fortune.

This work is fundamental for lawyers. It allows for the implementation of an appropriate patrimonial arrangement, as well as the adjustment of asset-holding structures and their function (as and when the family and the wealth evolves, and the societal and economic environment changes).

It is particularly important, when designing a succession plan, to name the asset managers (particularly professionals) and who will benefit from them.

In this context, family constitution not only allows for the designation of both the managers and the beneficiaries of the assets, but also explains the motivation behind the choices made by the settlor who can also define the conditions under which the management must be ensured and the distribution of assets carried out.

The family constitution must also facilitate the understanding or interpretation of a will or a letter of wishes. It must go beyond the legal arrangements, the instruments used and the countries in which persons and property are located.

It is sometimes difficult for the executor, the trustee or even the heirs to put the testamentary or trust provisions into perspective after the death of the founder or custodian. The family constitution will guide them towards the right decisions.

It can also serve as a posthumous testimony in case of dispute between the heirs. The family constitution will obviously not always be enforceable in court, but it can enable the amicable resolution of family disputes.

In this respect, it is important to remain vigilant so that the family constitution does not prescribe rules that are too strict or restrictive.

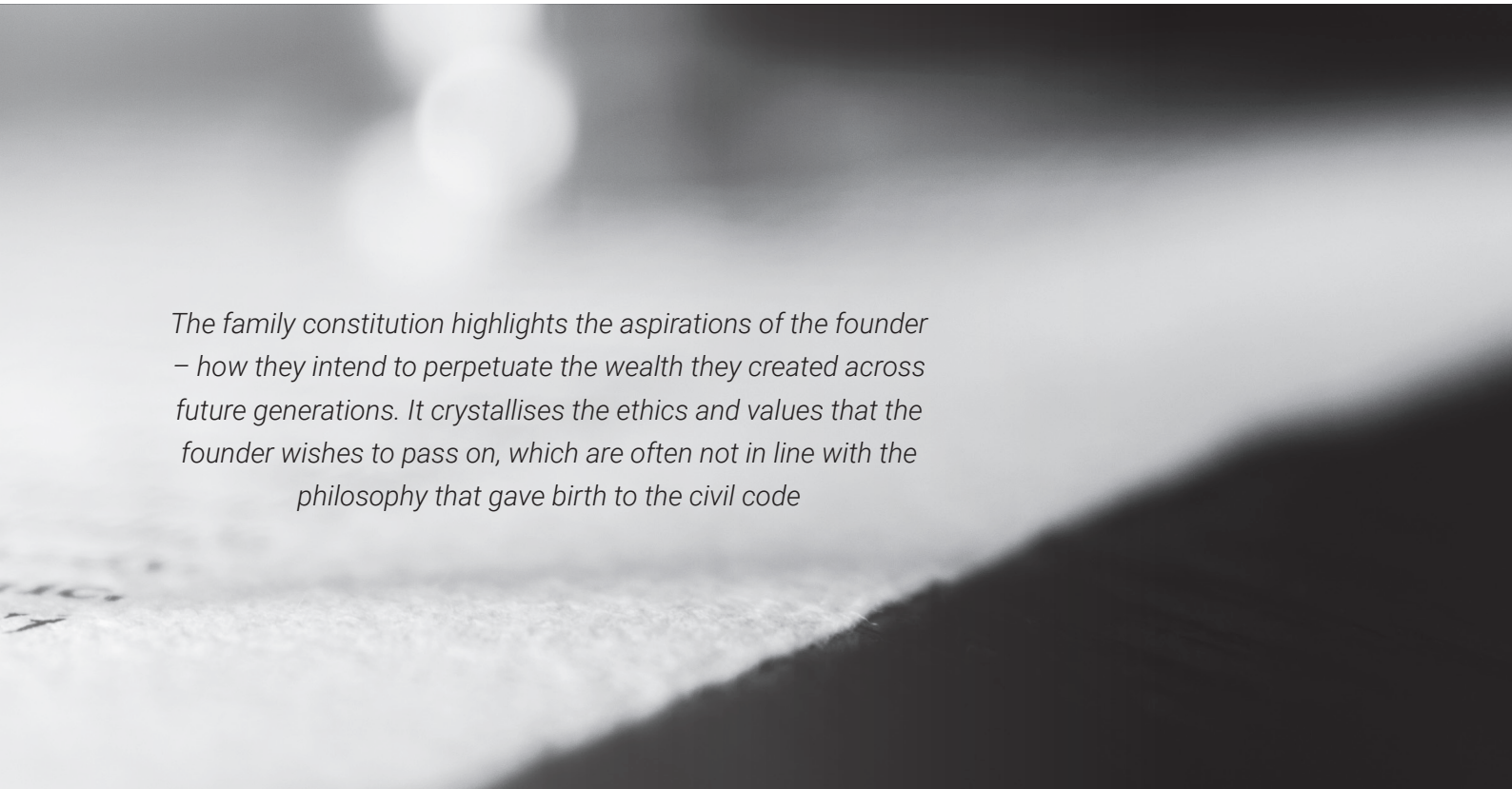
The pitfall to avoid is the successors having the impression of being placed under guardianship, and under the permanent control of their ancestors or predecessors.

THE FAMILY CONSTITUTION AS A LEGAL PREREQUISITE IN A CIVIL LAW ENVIRONMENT

Whether formalised or not, a family constitution is essential to help the lawyer identify the best tools for achieving family goals.

The best tools can only be ascertained on a case-by-case analysis. The standard structures that some may have used in the past more or less systematically – whatever the family aspirations – are (fortunately) no longer an option.

Some striking examples include the division of ownership between usufruct and bare ownership, when applied to cash in particular (so-called quasi-usufruct) for the sole purpose of evading taxation. This is now challenged systematically by the French tax authorities. Similarly, the so-called "offshore" structures, created secretly with the use of bearer shares and deposited in a helpful friend's safe, have ceased.



The family constitution highlights the aspirations of the founder – how they intend to perpetuate the wealth they created across future generations. It crystallises the ethics and values that the founder wishes to pass on, which are often not in line with the philosophy that gave birth to the civil code

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The family constitution must form an essential prerequisite to any legal, wealth and estate planning or restructuring. It highlights the aspirations of the founder – how they intend to perpetuate the wealth they created across future generations. It crystallises the ethics and values that the founder wishes to pass on to successors, which are often not in line with the philosophy that gave birth to the civil code.

Defining core values and priorities will, then, serve as a basis for identifying the most appropriate legal structures to be used, without being limited by the sole instruments provided by civil law.

At this stage, a differentiation may, as an example, be made between the assets which – according to the founder's vision – must be protected and perpetuated (such as business assets); those that the founder intends to bequeath to his or her heirs (such as "sentimental" assets); and those which are not subject to any particular attention.

The founder may generally draw a distinction between the assets to be managed (essentially business and financial structures), and the assets or proceeds that may be passed or distributed to the heirs.

On this specific point, one thing is clear: the instruments offered by the civil code prove, in practice, to be insufficient to achieve the objectives drawn by the founder (or the current custodians) of the family fortune.

As an example, under the rules provided by the civil code, no heir/legatee is obliged to remain in a "tenancy in common" scenario on an asset (*indivision*) as a result of a transfer by death, and may always claim for the end of this tenancy in common. This is often resolved through the sale of the concerned assets, when the other heirs cannot (or do not want to) repurchase the claimant's share. This very common situation is a clear obstacle to the founder's will to keep his or her estate intact and undivided in the future.

Similarly, the only instruments provided under the civil code are ineffective to protect vulnerable persons from themselves and others who may try to take advantage of them.

Curatorship (*curatelle*) or guardianship (*tutelle*) are indeed poorly arranged: these tools are either too loose or too restrictive, depending on the circumstances. In this respect, families – especially if they are from a civil law culture – must be allowed to consider instruments unknown to their legal system, but which prove to be the most appropriate for achieving their goals.

The trust, for example, can always be used in a civil law context (particularly in France, where their legal effect is recognised by courts), despite what we may be told.

In France, for example, the trust can be used to avoid the application of civil law principles inherited from the French Revolution, which are not always befitting of family ethics and values these days.

Of course, all possibilities must be considered; their advantages and disadvantages must be weighed against each other.

Eventually, the founders (or current custodians) of family wealth will determine the holding structure that best fits their needs, with the advice of their counsel.

Some fundamental rules must, however, be respected. Family members must understand the legal and tax consequences of the proposed structures, and be given simple view of the general scheme. This is key to ensuring that they are able to inform family members of the initial intentions that inspired the family constitution, and ideally to include them in it. This is why the structures must also be sufficiently clear and flexible to be modified as the family evolves, the economic or legal environment changes, or a crisis occurs.

In practice, this often implies limiting the number of founders of the family constitution. However, this solution is not suitable for every situation; some circumstances may, by contrast, demand the involvement of all the heirs together with the founders from the outset.

Above a certain threshold, the establishment of a formal or informal family constitution is the key to ensuring continuity, especially in a civil law context where the family fortune is to be divided at each generational shift, rather than being perpetuated.

There is no magic formula. Each situation calls for its own solution – one that is appropriate and perfectly suited to the specific situation.