INTERESTS IN POSSESSION, SETTLEMENTS AND *USUFRUIT*S, A FOREIGN PERSPECTIVE

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Given the historic penchant for Britons to acquire property in France, the issue of the Inheritance Tax treatment of a *usufruit* under French law over French property, movable or immovable, has come to the fore.

There are several contradictory decisions of the Capital Office, some treating these as interest in possession, or settlements, others taking the view that they are not. The Inheritance Tax consequences of a mis-definition can be catastrophic, giving rise to double taxation without any credit for French estate duty, as the French system does not treat the transaction in the way in which the United Kingdom would mistreat it.

Under these circumstances, it is perhaps time to review the position and ask "How does the French *usufruit* function?"

In the present context, it is a French succession and inheritance tax device. It can also be used with some effect in French corporate tax and financial planning, both on a national and international basis, but that is not the subject here.

French property law does not recognise trusts over French land on an internal basis, nor on a private international law basis. The quality of a trustee may be mentioned, but it has no legal significance beyond that. They may be applied, with caution, to French movables.

The same could be said for English law recognising a *usufruit* over English land: it is not a legal estate recognised under the Law of Property, these being limited to the Fee simple, and a Term of years.

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Roman Law was a highly pragmatic system. So are the systems which have developed from it. It dealt with the relationship between people and property on a purely financial basis; likewise, the Civil Law systems based on it. A little like the Common law introduced forcibly by the Normans in the 11th Century, where all rights had to be reduced to money or money's worth. It is curious that the Trust is therefore an invention of the Normans to palliate the fiscal effects of their feudal position.[2]

The reduction of property rights to money or to money's worth is the key to the civil law system, as is the issue of apparent ownership. It is the social value and impact that is regulated by law.

A *usufruit* arises on what is known as a *démembrement* (deconstruction) of the *pleine propriété* (full legal ownership) into its civil law constituent parts, namely: the right to the use, the right to the fruits and the remaining right of property including the right of destruction and disposal of the "*chose*" that is the legal title to the asset in question. These aspects are the public aspects of the *chose*. The Civil law does not concern itself overmuch with the morality and ethics of property, as opposed to the contrary tendency in Equity. Figuratively, it is a little like cutting a camembert into portions, rather than the English method which is to retain the full legal ownership at one level and subject it to equitable rights, on a separate dimensional plane of law. A *usufruit* is the combination of the right of user and the right to the fruits. It does not carry the right, automatically, to the capital gain arising on the sale or disposal or the property, although this can be agreed between the parties.

The *usufruit* right exists separately from the remaining right of destruction or disposal. It can be for a fixed term, or for life. What is more, further deconstructed *droits réels* (real as opposed to personal rights) exist, such as a *droit d'occupation*, which do not imply a right to the fruits. The use of a *droit d'occupation* might avoid the issues considered in this article.

A *usufruit* can be granted, acquired, or sold. It cannot be put out of existence by a transfer for consideration to a bona fide purchaser for value without notice. In other words, it is outside the scope of equitable considerations.

The *usufruit* is a *droit réel*. The categories and types of these French property rights are closed, no more can be invented[3]. It is not a personal right, unlike an interest in possession. In other words it does not depend for its existence on a higher or global property right as, by definition an equitable interest is required to do.

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2 *The French term it "le trust anglo-saxon"; the Normans having slaughtered the majority of the Anglo-saxon nobility and expropriated the rest! I am obliged to Nigel Goodeve-Docker for his continuing and humorous exposure of the growth of the Trust from this primitive system.*

3 *Even by the modern Anglo-saxon lawyer.*

This is not without consequence.

Firstly, the *usufruit* being a French *droit réel*, is an independent legal real right and is not a creature of equity, dependent upon the legal title or estate and upon the supervision and intervention of the English Courts for its existence.

It cannot therefore be analysed in an English manner as comprising an interest in the legal ownership of the property, based on an equitable obligation. This distinction has an effect on the valuation of the right. In France, for succession and donation purposes, the valuation of a life *usufruit*, *un usufruit à vie*, is calculated by reference to a statutory table, recently revised to take into account increased life expectancy and to the age of the *usufruitier*. The French system, including the tax system, operates on the basis that the right is extinguished on death or at its term, and is a wasting asset. The value is fixed by the parties in any contract for purchase, although the civil table can be used as a basis.

However, the French system of Succession Duty Tax and Wealth Tax has to operate by way of exception, and a statutory exception provides that the *usufruitier* is responsible for the Wealth tax, and is sometimes deemed to be the owner for estate duty purposes, although this deeming can be rebutted[4]. This does not square with the British Inheritance tax system, which is based on different assumptions as to property law and estate taxation. The UK principle is that the estate is valued as it stands at the moment immediately preceding the decease. On the other hand, the French system only taxes the transfer in the hands of the recipient, and at rates and allowances dependent upon the relationship which the recipient has with the donee or the deceased.

Were the worldwide estate to be valued on the basis of the French legal method of valuation of the *usufruit* at the moment before death, it would certainly not be the whole value of the *pleine-propriété*. At most, it could only the value paid for the *usufruit* at its inception if acquired by contract, or its value according to the statutory table, if obtained by gratuitous transfer on its grant. There at the very least is an argument for some relief as against the inclusion of the asset for the full market value in the English estate. If the French principle was carried through to its logical conclusion, the *usufruit* at the moment immediately preceding death could arguably have no value at all, which would square with the French legal position that it is extinguished on death.

Whilst the basic idea in IHTA 1984, s. 4(1) is that a person's estate is valued immediately before death, perhaps some further assistance can be taken from its qualification by s. 171, which provides:

4 *Quite simply at times.*

> *'(1) In determining the value of a person's estate immediately before his death changes in the value of his estate which have occurred by reason of the death and fall within subsection (2) below shall be taken into account as if they had occurred before the death.*
>
> *(2) A change falls within this subsection if it is an addition to the property comprised in the estate or an increase or* ***decrease*** *of the value of any property so comprised…'*

However, s. 171 IHTA specifically does not apply to the termination on death of any interest, e.g. a lease for life or to the passing of any interest by survivorship. Again we revert to the issue of whether the *droit réel* is an interest or a property right. As it cannot take effect in equity, it is arguably not an interest, in English terminology.

The principal effect of s. 171 is to bring into the tax charge property which either was not part of the deceased's estate at all before death, or which, until death, had a negligible realisation value. It is best illustrated by reference to the most common items which it will bring into charge.

Secondly, the decisions on the definition of an interest possession as including a right to income are not transposable to a *usufruit,* without more. These decisions are based upon a trust analysis of property and the rights pertaining to it, not a civil property law analysis, which by definition excludes any notion of beneficial interest or ownership.

Thirdly, Scots law has similar rights to a *usufruit* in the form of a proper liferent. Here, I defer to Scots advocates, and any further comment on the law of Scotland can be no more than that of an interested observer.

How is this treated for IHT purposes? It seems that the Interest in possession route is chosen:

'*Interest in possession'* is defined for Scots law in IHTA 1984, s. 46, as an interest of any kind under a settlement by virtue of which the person in right of that interest is entitled to the enjoyment of the property, or would be so entitled if the property were capable of enjoyment.

The phrase includes the interest of an assignee under an assignation of an interest of any kind in property subject to a proper liferent. The person in right of such an interest at any time is deemed to be entitled to a corresponding interest in the whole or any part of the property comprised in the settlement (which is not the case under the general law).

The crucial part of this definition is the requirement that the person be '*… entitled to the enjoyment of the property, or would be so entitled if the property were capable of*

enjoyment'. This corresponds closely to the decision in *Pearson v IRC* as to the meaning of the phrase for English law, and the Inland Revenue's interpretation, before their assimilation by Customs and Excise, set out in the 1976 Press Release may be regarded as a paraphrase of the Scottish provision.

The question whether a beneficiary's interest amounted to an interest in possession was discussed in a Scottish context in *Miller & Ors v IR Commrs* [1987] BTC 8, (1987) 1 CTC 273. In this case it was accepted by both sides that the formulation of the test in Pearson was applicable in Scotland. However, the liferent in question was constituted by a trust, and was not comparable to a *usufruit* under French law, which cannot be created by a trust.

The words 'or would be so entitled if the property were capable of enjoyment' were added to what is now IHTA 1984, s. 46 in 1976. This confirmed that a right in property which yields no income may still be an interest in possession. For example, a settled fund may consist of a farm which makes losses each year due to claims for capital allowances and stock relief, and therefore have no income available for the beneficiary. However, an interest in possession may yet subsist although the yield of income is nil.

The reference to proper liferents was added in 1980. An alimentary liferent falls within the definition of an interest in possession.

According to the Inland Revenue, as they then were, a proper liferent is not a trust. It developed within the law of heritable property, and in the rare cases where it is encountered, it is normally confined to heritage. It is constituted by the grantor conveying directly to the liferenter and to the fiar, or by conveying to the fiar and reserving the liferent. Until 1980, proper liferents were outside the scope of the settled property provisions: the liferent was not an interest in possession, and the fee was not a reversionary interest and hence not excluded property. Following pressure by the Law Society of Scotland, the Finance Act 1980 brought proper liferents into line with trust liferents in respect of transfers after 17 April 1980. Sub-paragraph (c) was inserted in what is now s. 43(4) above, and consequential amendments were made to the definitions of interest in possession and reversionary interest.

The 1980 amendments applied to any transfer of value made before 17 April 1980, if the accountable person so elects and payment of tax had not been made and accepted in full satisfaction of liability (FA 1980, s. 93(4)(b)).

The interest in the fee of property subject to a proper liferent is therefore excluded property within s. 48(1).

> 48(1) A reversionary interest is excluded property unless–

(a) it has at any time been acquired (whether by the person entitled to it or by a person previously entitled to it) for a consideration in money or money's worth, or

(b) it is one to which either the settlor or his spouse is or has been beneficially entitled, or

(c) it is the interest expectant on the determination of a lease treated as a settlement by virtue of section 43(3) above.[5]

I would therefore suggest that where one person acquires the *usufruit* for money or money's worth and another acquires the *nue-propriété* under the same token, the extinction of the *usufruit* does not give rise to a charge, and the property subject to the *usufruit* must remain outside the deceased's estate for IHT purposes, as it is not a settlement.

A *usufruit* can be created in several ways, which for these purposes include:

1. The owner of the full property selling or giving the residual legal ownership of the property to another, whilst retaining the *usufruit*;

2. The owner of the full property selling or giving the *usufruit* to another, retaining the residual legal ownership, or granting it to another; or

3. The *usufruitier* and the *nu-propriétaire* buying or acquiring the asset independently from the owner / vendor. This latter route is less orthodox, and has been subject to some criticism in France, but has been employed by several purchasers. It has the advantage of crystallising the value of the *Usufruit* as a separate property right, without the expense of a single purchase of the ownership and a further *donation partage*, subject to French gift duty in addition to the stamp duty on the conveyance. However, unless care is taken, it does not prevent the statutory presumption contained in article 751 CGI from requiring, unless proof is provided to the contrary, that property remains within the estate of the *usufruitier* on death.

Quid Reservation of Benefit?

Whilst it is superficially arguable that the first method of grant contains a reservation of benefit, this is manifestly not the case from perspective of the civil law, as it consists of a carving up of the property into different rights, the estate of the donor

5 *Reference is made with thanks to the CCH commentary on Inheritance tax from which this is liberally plagiarised*

retaining a reduced right, capable of valuation and disposal independently of the residual ownership rights.

There are two issues which can be raised;

1. Is a *usufruit* an interest in possession? And

2. Is its retention, grant or purchase out of the residual ownership, a settlement in any shape or form?

1. Is a usufruit an interest in possession?

It is trite English law that a present interest in present income is an interest in possession, when it concerns English property.

The *usufruit* being both the right of user and the right to the fruits, it would appear to fall within the definition at first glance. On the other hand it is a *droit réel*, not a mere interest.

That does not mean that the same analysis can be applied to a foreign legal concept, outside the jurisdiction of the English Courts. There is a strong case that, without an equitable interest dependent upon a foreign legal ownership right, the English Courts cannot have any jurisdiction over the content of a foreign property right. That notwithstanding, they may have jurisdiction over one or more of the persons concerned in the event of say a constructive trust remedy being sought over foreign property[6].

2. Is its retention of a usufruit out of the pleine propriété, granting or transferring the right of disposal to another, a settlement?

The purchase of the *nue-propriété* from an owner, leaving the owner with the residual real rights to the fruits and the use, it is argued cannot be a settlement.

In another context, although 'settled property' is defined in the context of certain non-resident settlements and the 'connected persons' definition in TCGA 1992, s. 286(3), 'settlement' itself is not.

In *Roome and Denne v Edwards* (1981) 54 TC 359, Lord Wilberforce stated clearly that "... *'settlement' must be a situation in which property is held in trust*". Aside that trenchant definition for the purposes of English law, this is clearly impossible in a civil law jurisdiction where the concept of beneficial ownership of property is anathema. Whilst the case was a Capital Gains issue, the lack of definition in the TCGA legislation is comparable to that in the IHTA.

6 *cf The European Court of Justice in the case of Webb - Case C-294/92 Webb v Webb [1994] ECR I-1717*

However, in s. 43 IHTA an attempt may have been made to override this;

> *s.43(2) Settlement means any disposition or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being–*
>
> *... or*
>
> *(c) charged or burdened (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period,*
>
> *or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the United Kingdom; or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened.*

However, a *usufruit* is not a charge, or a burden: it is a *droit* or a right, and therefore falls outside the definition of a charge or burden "*whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, or charged or burdened*". S. 43(2)(c) is therefore inapplicable to a *usufruit*, as it is not a charge or a burden neither is the property "administered" in the sense of a settlement. There is no administration, there is no probate.

It is worth noting that the legislator at s. 43(2)(a) and (b) uses the term "held in trust" to define settled property. This would indicate that the underlying principle of s. 43 is indeed based on the existence of a trust, or a foreign property arrangement which is assimilated to one. Again, there is no concept of a trust of French land to which the *usufruit* can be assimilated.

s. 43(2)(c) by its wording can only apply to a disposition of property by which it is burdened or charged with a periodic payment or annuity. The French for annuity is *rente*. The *usufruit* is neither of these. It is the income right, not a charge or a burden. Indeed, in some circumstances where children wish to have the full value of property subject to a *usufruit* in favour of a surviving parent, one method for them is to apply that the *usufruit* be converted into a *rente*. This right can be excluded by will. That in itself is proof that the *usufruit* is neither a charge nor an annuity.

The same argument applies where the *pleine propriétaire* grants a *usufruit* to another by way of gift. This is not equivalent to a charge equivalent to the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period.

However, the last paragraph is a general one ".. or would be so held or charged or burdened…" if the disposition were regulated by the law of any part of the United Kingdom; in other words including Scotland, but not the Bailiwicks of Jersey and Guernsey where the *usufruit* is a conveyancing technique still regularly employed under the anglicism "life enjoyment".

The *usufruit* still escapes, perhaps with its clothing slightly singed, if the *usufruit* rights are acquired by one purchaser for valuable consideration from a third party, and the *nue-propriété* for valuable consideration by another.

As mentioned above, a life rent under Scots Law is assimilated to an 'interest in possession' for IHT purposes, but not by mere operation of law.

There is no doubt that, taken on its own, the definition of 'interest in possession' given in *Pearson and others v IRC* [1980] STC 318 as bearing its ordinary natural meaning; a present right of present enjoyment of income, could prima facie comprehend a *usufruit*. However, that would imply a settlement, a trust, which cannot be the case under French law, unless s. 43(2)(c) can be invoked to deem one. In the author's view, it cannot.

The difficulty is that such a requirement would in fact mean double taxation in the United Kingdom of the French property: once on the death of the *usufruitier*, if domiciled in the United Kingdom, and secondly on the death of the owner. In France there would only be one tax point, on the death of the owner, as the *usufruit* is extinguished on death, without a succession duty charge, as there is no chargeable transfer: the iniquitous result is double taxation in the United Kingdom of the property on two disposals with no effective credit for one.

It is more than arguable that the *usufruit* right cannot be comprehended within the definition of an "interest in possession" under the English system, as it does not depend for its existence on an equitable estate out of the full legal ownership. What is clear is that a *usufruit* acquired independently for valuable consideration should not be treated as a part of a settlement.

The author has been unable to locate any decision on the point.

The difference between a *usufruit* and a *droit d'occupation*

Here one point has to be clear. The French tax code does not have the effect of civil law *per se*. It is based upon principles of law, which remain for the most part unwritten, and it amends it in certain circumstances with a limited objective. In this case, the presumption merely applies to *usufruits* and not to the other types of *droit réel* which can exist over property, such as a *droit d'occupation*.

Further investigation into the French tax treatment of a *usufruit* reveals that the tax administration has had to have a statutory presumption inserted into article 751 CGI to the effect that where a deceased owned a *usufruit* over an asset, the asset is presumed to remain within the estate of the deceased for its full value, unless the contrary is evidenced or unless the *nue-propriété* was given by the *usufruitier* under notarised gift.

The provision was recently amended in article 14 of *Loi de finances pour 2008* following a recent decision of the *Cour de cassation*, on its scope. The Court had held that the presumption was maintained even in a case where the deceased had given money to the *nu-propriétaire* to acquire the *nue-propriété* for full value, at the time when the *usufruitier* purchased that right from the independent vendor. The law now provides that under certain restrictions as to form, a purchase by the *nu-propriétaire* for value can remove the property from this presumption, on the basis not of the scope of the provision, but rather on the basis that evidence can be provided to the contrary:

> *« La preuve contraire peut notamment résulter d'une donation des deniers constatée par un acte ayant date certaine, quel qu'en soit l'auteur, en vue de financer, plus de trois mois avant le décès, l'acquisition de tout ou partie de la nue-propriété d'un bien, sous réserve de justifier de l'origine des deniers dans l'acte en constatant l'emploi. »*
>
> "Proof to the contrary may in particular arise from a gift of money made by a deed having a legally binding date, irrespective of its author[7], with a view to financing, more than three months prior to the decease, the acquisition of all or part of the *nue-propriété* of an asset, subject to justifying the origin of the money in the deed laying down its object" (author's deliberately literal translation).

This amendment whereby the gift of money used subsequently in the purchase of the *usufruit* specifically rebuts the presumption was proposed by the administration following the decision.

7 The deed can therefore either be notarised or under private seal : *sous seign privé*

The reason for this presumption, or deeming provision, is that succession duty followed the apparent ownership of the property, as it still does in other areas. Again, this has little to do with the English notion of a settlement.

This provision never applied to a *droit d'occupation*, which has never been capable of triggering the presumption in article 751 for succession duty, despite it being considered equivalent to a *usufruit* for Wealth tax purposes. There is no conceptual inconsistency here, given the different nature of the two taxes, albeit both within the generic category of *droits d'enregistrement*.

Capital Taxes Office, Nottingham has recently accepted that a *droit d'occupation* does not constitute a settlement. It is equally possible that a *usufruit* might escape this treatment for the reasons set out above.

Conclusion

The French transaction has an entirely different legal effect to, and therefore cannot be correctly analysed as, an interest in possession, without a degree of deeming going beyond that which might be permitted in a purely national context.

In the author's view, the *usufruit* under French law cannot be assimilated to a settlement or an interest in possession, as French law does not recognise trusts over French immovable property in its own internal law, even under private international law.

Whilst it might be arguable that s. 43(2) might catch a *usufruit* reserved by the owner on a gift of the *nue-propriété*, it is clear that the acquisition of a *usufruit* at purchase from the vendor by one party and the *nue-propriété* by another for value is outside the charging provision of a settlement, and cannot be assimilated to a charge or burden.

Finally, overdue reliance may be placed upon the legal training of translators in this field. Certain French translators have taken up the habit of translating a *usufruit* as a Life Interest, and are therefore infecting the ground with this uninformed mistranslation, despite the change to the Eurodic website. A French translator attempting to impose a pan-European concept should have their draft returned to them requesting that a translation of *usufruit* by Life Interest be replaced with the English term which is usufruct.