

The impact of foreign property regimes on offshore trusts

Insights - 25/04/2023

The community property regime is not one which is necessarily familiar to all professionals practicing in the private client space and it may be a trap for unwary clients with cross-border interests wishing to protect their assets using wealth planning tools. This article discusses the implications of the community property regime and how it affects trusts and similar structures.

What is community property?

Community property is a marital property regime which originated in civil law jurisdictions, and is found in mainland China, California, Germany, Italy, France, and Sweden, among other jurisdictions. Broadly speaking the regime is one which treats property acquired during a marriage as "community property" between spouses such that, in the event of divorce, that property is subject to division between spouses pursuant to specific rules. Each jurisdiction has its own particular regime which should be considered carefully in each case.

Taking mainland China as an example, in general, property is separated as that owned by a spouse in their own right and property owned by the spouses together, the latter being community property. All property owned by a spouse before marriage, including gifts and inheritance received by that spouse (in certain circumstances) is treated as that spouse's separate property owned in their own right. Any other property acquired during marriage is treated as community property and will be divided between them in the event of divorce.

On one level, the principles to be applied seem straightforward but, in reality, the concept of community property is much more complex with various exceptions. The issue of whether particular property is a separate property or should be treated as community property is often disputed.

It should be noted that community property is different from matrimonial property, or the resource of a spouse, in matrimonial proceedings. In divorce proceedings, if an asset is treated as a

resource available to a spouse, then that asset will be taken into account when calculating the global asset pool of the spouses, and subsequently divided between the spouses in accordance with relevant matrimonial law principles. Importantly, this characterisation does not invalidate the established trust or affect the validity of any previous transfer of assets into the trust; it simply is a matter which is taken into account when determining the financial provisions to be made in the divorce proceedings. By contrast, if property is designated community property, then that property can only be disposed of by both spouses providing joint consent. If such consent is not forthcoming, the disposition of property, for example into trust, could be liable to challenge. In turn, this may affect the validity of any previous transfer of assets into the trust, or the establishment of the trust itself.

Forced heirship

Forced heirship is also a concept to be considered alongside the community property regime as it also affects a person's freedom to dispose of assets, either during their lifetime or after death.

The effect of forced heirship differs by jurisdiction. In summary though it is a statutory inheritance regime which provides for the inheritance of 'forced shares' of specific property to family members of express degrees of relation (ie parent to child) upon an individual's death. While this article does not address forced heirship in depth, the concept is similar to the community property regime in that any transfer of property into trust could be met with later challenge, if the property could be considered part of a 'forced share' under the relevant forced heirship regime.

Impact on estate planning

Clients in jurisdictions which have a community property regime or forced heirship regime should consider the impact of either when carrying out estate planning. In particular, if an individual intends to use Cayman law vehicles or trust structures as part of their estate planning, then they should consider structuring alongside local law advice on the relevant community property or forced heirship regime to ensure that any estate planning is safeguarded from future challenge.

Does the firewall provision help?

Many offshore jurisdictions have firewall provisions in their respective trust statutes which provides robust protection by ensuring the application of the relevant offshore law to all matters related to trusts established in that jurisdiction and limits the recognition and enforceability of judgments of foreign courts inconsistent with that offshore law. For example, in the Cayman Islands, section 90 of the Trusts Act (2021 Revision) provides that all questions in respect of a trust that is governed by Cayman Islands law, including the disposition or transfer of property to that trust, shall be determined in accordance with Cayman Islands law without reference to the laws of any other jurisdiction with which the trust may be connected.

Similarly, with respect to forced heirship rules, sections 91(b) and 92 of the Trusts Act provide some

assurance for practitioners advising on Cayman law trusts where parties are resident in jurisdictions with forced heirship regimes.

However, these protections are subject to certain provisos. For example, they will not operate to validate a disposition of property that the settlor does not own as a matter of the law governing ownership of that property nor will it validate any trust or disposition of immovable property situate outside of the Cayman Islands, or any testamentary trust or disposition that is invalid according to the laws of the testator's domicile.

Conclusion

The application of these regimes in the offshore context is complex and, although the firewall provisions themselves may be helpful, they are not necessarily a "cure-all".

Accordingly, it is advisable for settlors and asset donors from jurisdictions with community property or forced heirship regimes to seek advice from qualified offshore practitioners before seeking to establish trusts or settle assets upon existing trusts to avoid potential disputes arising at a later stage.

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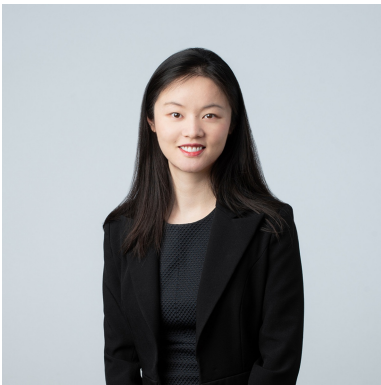
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