International tax treatment of trusts*

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1. Introduction

In recent years there seems to be a renewed interest in the tax consequences of the Anglo-American trust in a number of countries. This special issue of WPNR would not be complete without discussing the tax treatment of the trust phenomenon in "surrounding" countries. It is useful to pay attention to the tax law as it stands in two Anglo-American jurisdictions, the United Kingdom and the United States, where the trust plays a part in almost any sphere of life. A Frenchman in relation to the trust once remarked: *'Si l'on se demande à quoi sert le trust, on peut presque répondre: "à tout"! Il est plus indispensable que le thé à la vie anglaise et le base-ball à la vie américaine'*.[1] As a result of the ubiquity and variety of trusts, those two countries have developed sophisticated sets of rules to deal with this legal phenomenon. It is equally important to take a look at the legislation of countries which – as the Netherlands - are being confronted with this alien concept - a concept which raises a number of tax issues that need to be solved. In this respect we will focus on the following civil law countries: Belgium, France, Germany, Italy, The Netherlands, Spain and Switzerland.

In this article we will summarize some of the most important inheritance and gift tax rules applicable to trusts in the countries mentioned.[2] We assume that readers are already familiar with the general tax rules relating to income tax and inheritance and gift tax in the various countries. Please note too that the purpose of this article is not to give an in depth analysis of the tax treatment of trusts in each country. Instead, this article can be considered as a first introduction to the most relevant and notable legislation, regulations and procedures that each country applies to trusts. We will conclude with some general remarks.

2. Country analysis

As mentioned above, the trust concept is alien to civil law countries. However, this does not mean that these countries do not recognize the trust as such. In this respect, mention should be made of the Hague Convention of 1 July 1985 on the law applicable to trusts and their recognition.[3] This Convention solves a number of questions raised by the appearance of the trust in civil law jurisdictions. For example, as a result of this Convention, trusts will be recognized insofar as they fall within the description of the trust given in this Convention.[4] However, article 19 of the Convention explicitly states that nothing in the Convention shall prejudice the powers of States in fiscal matters. Consequently, all States are permitted to deal in fiscal matters with trusts in the way they prefer and the reader will notice significant

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We would like to thank the members of the Estate Club for their contributions to this article. The Estate Club was founded by Mr. Deblauwe and Mr. Sonneveldt some years ago and brings together (international) estate planning specialists from various countries. Members of the Estate Club meet once every seven months to exchange country-specific information relevant to international estate planning. Membership is by invitation only. Current members are Ms. Anouck Biesmans and Mr. Rik Deblauwe (Belgium), Mrs. Julia Novak and Mr. Jérôme Barré (France), Mr. Marc Juelicher (Germany), Mr. Guglielmo Maisto and Mr. Alessandro Bavila (Italy), Ms. Bianca de Kroon and Mr. Frans Sonneveldt (the Netherlands), Mrs. Patricia Garcia (Spain), Mrs. Kinga Weiss and Mr. Stephan Neidhardt (Switzerland), Mr. Nigel Eastaway and mr. Ian Maston (United Kingdom) and Mrs. Leigh-Alexandra Basha (United States).

1. P. Lepaulle, *Traité théorique et pratique des Trusts*, Paris, 1932, p. 12.
2. The law is stated as at August 2013.
3. Of the countries discussed in this article, the Convention is effective in Italy (as of 1 January 1992), the Netherlands (as of 1 February 1996), Switzerland (as of 1 July 2007) and the United Kingdom (as of 1 January 1992).
4. Article 1 of the Convention stipulates that for the purposes of this Convention, the term "trust" refers to the legal relationships created - *inter vivos* or on death - by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose. A trust has the following characteristics
a) the assets constitute a separate fund and are not a part of the trustee's own estate;
b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.
The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.

differences in the approaches adopted. Broadly speaking two different systems can be recognized. First, there are systems where the trust is simply brushed aside for tax purposes. Secondly, there are systems where the trust is considered a special purpose vehicle. We discuss this difference in more detail below.

3. Belgium[5]

To understand the Belgium fiscal approach to trusts, it is important to make a distinction between bare trusts[6], fixed interest trusts[7] and discretionary trusts[8]. In case of a bare trust[9], according to Belgium law the beneficiaries are the owners of the trust assets. This kind of trust will be considered transparent for fiscal purposes.

The transfer of property to a trust may be considered as a gift. The gift could be taxable with inheritance taxes if the settlor dies within a period of three years after the transfer of the assets to the trust.

Distributions to a Belgium resident taxpayer from a fixed interest trust will be taxable for income tax purposes against a rate of 25%[10], but only if the distributions made qualify as so called 'interest income'. No income tax is levied on distributions of capital. When distributions are made from a discretionary trust, there are no income tax consequences if the beneficiary and the settlor are different persons. The tax consequences are ambiguous if the settlor himself is also one of the beneficiaries or the sole beneficiary.

In case of a bare trust or fixed trust, the death of the settlor can give rise to inheritance tax which will be levied on the entire trust estate. When the settlor of a discretionary trust passes away, inheritance tax will only be levied on the distributions which have a direct link with the death of the settlor.[11]

4. France[12]

In the past France was very suspicious of trusts. Understood as a UFO, only article 120-9 of the Code General des Impôts (French Tax Code)[13] was providing income tax rules about trusts. Therefore, pursuant to this article, where the beneficiary of the trust income is a French tax resident, the gains attributed to the beneficiary are taxable in France.

From an international perspective, France has signed only two double taxation treaties (DTT) with respect to income tax that specifically refer to trusts, i.e. the France-Canada DTT and the France-US DTT. If the question about income distributed by a trust was rather well known, the issues about wealth tax and inheritance/gift tax were more delicate. Indeed, these issues were settled by some French Courts which regarding irrevocable and discretionary trusts ruled in favour of the taxpayer (assets held by trust were not considered subject to wealth tax[14] and no inheritance or gift tax until there was a distribution of capital).

In 2009, during the first official campaign of voluntary disclosure of foreign assets, some French tax advisors had undermined the position that the settlor of an irrevocable trust should be regarded as no longer having the power to dispose of the assets by presenting files where irrevocable trusts were revoked!

In 2011, after the voluntary disclosure campaign, new articles were added to the French Tax Code, providing new French tax rules regarding wealth tax and inheritance and gift tax, which apply whatever the characteristics of the trust (irrevocable or revocable, discretionary or non-discretionary).

By creating legal tax rules on foreign trusts, the 2011 bill dramatically changed the French tax exposure of settlors who were French tax residents upon the setting up of the trust, French beneficiaries of a trust, non French settlors and trustees and beneficiaries of foreign trusts holding French assets.

One of the rules that stands out when compared to other countries, is the obligation of trustees to report the establishment, any modification and/or the termination of the trust as well as the contents of its portfolio, if the settlor or one of the beneficiaries is a French tax resident or if the trust assets consist of French situs property.[15] Additionally, the trustee is obliged to report the market value of the trust assets as per 1 January of each year.[16]

French wealth tax is due by the settlor[17] on all

5. Thanks to Mr. Deblauwe, rik.deblauwe@tiberghien.com and Ms. Biesmans, also via: rik.deblauwe@tiberghien.com.
6. Under a bare trust, assets are transferred by the settlor to the legal ownership of the trustee, or nominee, for the benefit of the beneficiaries. Eastaway, Richards and Kimber, Tax Advisers' Guide to Trusts, Bloomsbury Professional, Fourth Edition, 2010.
7. The beneficiaries have a (legally enforceable) claim against the trustee, who owns the trust assets.
8. The beneficiaries have no legally enforceable rights against the trustee, until the moment that the trustee decides to distribute certain assets.
9. Also: sham trust.
10. Rate as at 2013.
11. Some writers have made objections against this rule and argue that a transfer in trust is to be considered an indirect gift to the beneficiaries. According to this view, inheritance tax could only be due if the settlor dies within a period of three years after the transfer of the assets in trust. See: Anouck Biesmans and Rik Deblauwe, The times, they are a changing..., Guide to The Wrld's leading trusts and Estate Practitioners, and Deblauwe, Rik, Inleiding tot de successierechten, Knops Publishing, 2013, 91, nr. 171 -173.
12. Thanks to Mrs. Novak, jnovak@franklin-paris.com and Mr. Barré, jbarre@franklin-paris.com.
13. "The following are considered as (investment) income: trust gains regardless of the nature of the assets held by the trust".
14. First-level Court of Nanterre 2nd division, 4 May 2004, no. 03/09350, Commercial division of the Court of Cassation, 31 March 2009, no. 07-20.219.
15. Article 1649 AB, paragraph 1 of the French Tax Code. This rule is applicable as per 1 August 2011.
16. Article 1649 AB, paragraph 2 of the French Tax Code. Any failure by a trustee to comply with this requirement carries a fine of the higher of EUR 10,000 or 5% of the value of the trusts assets (2013).
17. Or the beneficiary if the settlor is deceased.

assets and rights held in trust established by a French tax resident settlor.[18] If the settlor is a non-French tax resident, wealth tax is due on French situs property.[19]
Only distributed "products" of a trust are considered to be taxable income. This income is chargeable to progressive income tax rates,[20] social security contributions[21] and occasionally to exceptional contributions[22] on high income. Additionnaly, a distribution made results in an obligation for both the trustee and any beneficiary who is a French tax resident, to file a tax return in relation to that distribution in the month following the month in which the distribution is made. If the trust is established in a low-tax jurisdiction, there may also be French income tax consequences even if no distributions are made by the trust.[23]
The death of the settlor can give rise to French inheritance tax, whether or not the capital is actually transferred to the beneficiaries. In other words, even if the property remains in the trust from generation to generation, inheritance tax is assessed in the same manner on all successive beneficiaries.[24] This will only be the case if the settlor was a French tax resident, if the property held in trust was located in France or if the beneficiary is a French tax resident.[25] If the share of the property devolving to a beneficiary can be determined, this share is subject to inheritance tax according to the consanguinity between the settlor and the beneficiary. If the share cannot be determined, specific rates apply.

5. Germany[26]

First, mention should be made of the fact that Germany does not *formally* recognise trusts and has not signed the Hague Convention on the Law Applicable to Trusts. The tax law is however "open-minded" in this respect, in order to prevent the use of sophisticated (foreign) planning opportunities, such as the Anglo-American trust, with the sole intention of minimizing the tax burden.
Thus, Germany will first tax a transfer of assets to a trust[27] with inheritance or gift tax, either as death-time-transfer or as a life-time-transfer provided of course that Germany has a right to tax on the basis of residence of the transferor or situs. The dissolution of the trust produces a second taxable event. Taxation is based on the personal kinship between the settlor and the beneficiary. The beneficiary will be taxed according to his share of the distributed capital.
One of the most difficult taxation schemes in relation to the taxation of trusts concerns the treatment of so called "intermediary beneficiaries".[28] There is no statutory definition, but the Federal High Tax Court ruled that an intermediate beneficiary can be a mere income beneficiary, a capital beneficiary receiving distributions of capital before the trust is terminated, or in fact anybody (except the settlor) who receives any benefit from the trust during its existence. In this respect, the taxation of income beneficiaries leads to an internal double taxation with German income tax and German inheritance and gift tax, for which only a limited mutual tax credit between both taxes is granted.[29]

6. Italy[30]

In Italy, there are no specific legal provisions on the taxation of trusts for the purpose of Italian inheritance and gift tax; however, the matter has been dealt with quite extensively by the Tax Authorities through circular letters of 2007 and 2008.[31] The Tax Authorities have taken the view that inheritance tax must apply at the time of the settlement of the property (as opposed to the time of vesting).
Although the applicable rate is determined by reference to the relationship between the settlor and the beneficiaries, the trust is liable to the payment of the tax (as if it were a taxable person). If it is impossible to ascertain the precise value of the assets passing to each beneficiary, or if the identity of the final beneficiaries cannot be ascertained in a particular case, one must apply the highest rate as the case may be.
Although the aforementioned position has been officially stated and is applied by the Tax Authorities, it is questionable if this scheme can be accepted on the ground of the general principles of tax law and constitutional provisions. Some scholars therefore argue that the better view is that gift tax should be due at the time of the establishment of the trust only if it is clear at the outset what share of the capital will go to each of the beneficiaries, or what rights are assigned to them, while in any other case

18. When the settlor passes away the beneficiaries are considered to be settlor (the so-called deemed settlor) for wealth tax (and inheritance/gift tax) purposes. In case the shares of the beneficiaries are not precisely defined, the trust property will be divided in equal portions and allocated to the beneficiaries as deemed settlors (BOI-PAT-ISF-30-20-30 §70).
19. French situs property includes: French real estate, shares and interests in a company the value of which derives mainly from real estate property located in France and shares of a company which directly holds real estate located in France.
20. For a married couple the progressive tax rates run from 0% to 45% for incomes up to EUR 300,000. A flat rate of 45% is applicable for income over EUR 300,000.
21. 15,5% in 2013.
22. For a married couple 3% on the difference between EUR 500,000 and EUR 1,000,000, and 4% over EUR 1,000,000.
23. Article 123 bis of the French Tax Code.
24. French inheritance taxes are due by the beneficiaries.
25. The beneficiary is considered a tax resident of France if he had been resident in France for six years out of the last ten years preceding the death of the settlor or the distribution.
26. Thanks to Mr. Juelicher, marc.juelicher@fgs.de.
27. As well as any other foreign entity without legal personality.
28. Zwischenberechtigte.
29. There is a pending case in front of the Federal Constitutional Court in Karlsruhe against the allegedly violation of the constitution by the internal double taxation of the same tax object by income tax and inheritance tax.
30. Thanks to Mr. Bavila, a.bavila@maisto.it.
31. Circular 48/E and Circular letter 22 January 2008, No. 3/E.

the tax should be due only when the capital is actually vested. This latter view has been shared in many recent cases decided by first instance tax courts.[32] The Tax Authorities have not, however, so far changed the 'official' position and which therefore continues to be applied by Italian tax offices. It is likely that this view will be changed, however, once the above mentioned cases have been considered by the higher courts.

As for income taxation, if an Italian resident beneficiary has a current entitlement to the trust income and capital (fixed interest trust)[33], the worldwide[34] income of the trust is apportioned to him (according to his share of participation resulting from the trust deed or any subsequent document, or, in default, in equal parts) and will be taxed in his hands accordingly.[35] Moreover, trusts where either the settlor or the beneficiaries are the de facto owners of the trust property or revocable trusts,[36] will be disregarded for tax purposes and the income will be determined and taxed in the hands of either the settlor or the beneficiaries. Income from genuinely irrevocable discretionary trusts, is taxed in the hands of trust according to Italian tax rules applicable to commercial or non-commercial bodies.

7. The Netherlands[37]

In this special issue of WPNR various authors have extensively dealt with the trust and the Dutch approach to trusts. However, for the non-Dutch reader, we will here briefly summarize the main provisions applicable to the tax treatment of trusts in the Netherlands.

As of 1 January 2010, the Netherlands changed its inheritance and gift tax legislation significantly. Some of the measures were introduced to combat tax avoidance and regulate the tax treatment of the Anglo-American trust (and similar relationships or institutions). More generally, the concept of segregated private wealth (*afgezonderd particulier vermogen*) was launched. In short, the provisions result in the tax transparency of the Anglo-American trust vis-á-vis the settlor. As a consequence, the transfer of assets to the trust by a settlor who is a (deemed) resident of the Netherlands no longer constitutes a taxable event for Dutch gift tax purposes.[38] The trust assets are deemed to remain part of the property of the settlor and will be taxed accordingly (income tax).

As soon as distributions are made to the beneficiary, or the beneficiary receives a legally enforceable right with regard to the trust property, the beneficiary is considered enriched and Dutch gift tax will be levied. If the assets remain in trust, a Dutch resident beneficiary will be taxed for income tax purposes. Upon the death of the settlor, the allocation of the assets shifts from the settlor to his heirs. In other words, the assets will – for fiscal purposes only – be deemed to form part of the estate of the settlor and his heirs will be deemed to have acquired those assets in the same proportion as their share in the inheritance. Those heirs will have to pay Dutch inheritance tax accordingly, even if they do not expect to receive anything from the trust funds.[39] This system is comparable to the system in France, with the important difference that in France the trust assets will be attributed to the beneficiaries, who are not necessarily the same people as the heirs.

8. Spain[40]

Spain does not have comprehensive legislation on the treatment of trusts for Spanish tax or other legal purposes. The only guidelines as to the tax and legal treatment of trusts are contained in a very limited number of domestic rulings issued by the Spanish tax authorities and scarce case law. From this some general conclusions can be drawn which will be discussed hereunder.

First of all, external trustees are considered to act as mere administrators of the trust assets. Changes in external trustees therefore have no relevance for Spanish tax purposes.[41]

As the trust is an arrangement alien to Spanish law and Spain is not signatory to the Hague Convention on trusts, trust arrangements are often considered null and void for Spanish tax purposes and are likely to be ignored for tax purposes. This was the case when a citizen of Panama, tax resident in Spain and settlor of a Guernsey trust was also the beneficiary of the trust during her lifetime. Her grandchildren held a reversionary interest on her death. Following the settlor's death, the grandchildren were subject to Spanish inheritance tax on all net assets of the trust at the time of the settlor's death. In this case, the Spanish tax consequences were construed by assuming that there has been a direct free mortis

32. The Provincial Tax Court of Florence stated in 2009 that inheritance and gift tax must be applied only when assets are actually transferred in favor of somebody. A similar position has been taken by Tax Courts in several more recent cases: Tax Court of First Instance of Pesaro no. 287 of 9 August 2010; Tax Court of First Instance of Perugia decision no.35 of 27 January 2011; Tax Court of Secondo Instance of Venezia, decision No. 10 of 21 February 2012; Tax Court of Second Instance of Milan, decision no. 73 of 4 July 2012.
33. Transparent trust.
34. Circular letter of 27 December 2010, No 61/E.
35. Article 73(2) Italian Tax Act.
36. Interposed trusts.
37. This paragraph is partially based on F. Sonneveldt and M. Vrijmoed, Estate Planning in the Netherlands, to be published as a chapter in a book on international estate planning by L. Basha.
38. This approach used to be different in the past.
39. There are two important exceptions to the aforementioned transparency rule. Firstly, if an heir can prove that he is not a beneficiary and never can become one, the trust property may not be allocated to the heir. To prove this the heir will have to show documents from which the Tax Authorities can derive who are the beneficiaries to tax them accordingly. Secondly, if the trust itself is subject to taxation at a rate of at least 10%.
40. Thanks to Mrs. Garcia, patricia.garcia@avantia-fo.com.
41. Rulings 1691-97 and 0653-98 published in 1997 and 1998 respectively confirm that a change of trustee does not imply a change of beneficial ownership in the trust property.

causa transfer from the settlor to the beneficiaries at the time of the settlor's death.[42]
Mention should be made of the 2012 Special Voluntary Disclosure facility and the new annual Foreign Asset Information Returns which consider beneficial owners of assets as true owners of assets for Spanish tax purposes. Beneficial owners are in this respect, among others, individuals who own or exercise control over at least 25% of the assets of a legal instrument or entity which distributes funds, or when the beneficiaries are pending appointment, the category of individuals in whose benefit the assets are administered by the entity or legal instrument. According to the Spanish tax authorities, this implies that if the settlor is resident in Spain, he is required to report the foreign situs assets held in trust as "owner" of the assets. If the beneficiaries are resident in Spain, and they are actual and effective beneficiaries and not merely "potential" beneficiaries, they are obliged to report the foreign situs bank accounts and annuities.
The guidance provided by the Spanish tax administration is very limited, and legislation is lacking in this area. Therefore, the Spanish tax treatment of trusts should be assessed on a case by case basis, taking into account, among other factors, the reasons supporting the trust´s creation, its revocability, the powers of the trustees, the settlors and the beneficiaries and the provisions of any letter of wishes.

9. Switzerland[43]

Switzerland ratified the Hague Convention on the Law Applicable to Trusts relatively recently.[44]
Despite this ratification, foreign trusts still do not constitute legal entities in Switzerland and therefore cannot be subject to tax. However, the Swiss Tax Conference and the Federal Tax Administration have issued circulars on the taxation of trusts for wealth tax and income tax purposes. According to these circulars, the trustee and/or the protector of the trust are neither subject to taxation on the trust assets nor on the income derived from the trust. Rather, the circulars provide for the taxation either of the settlor or of the beneficiary, depending on the trust arrangement.
In a case where the trust qualifies as a revocable trust, the assets and the income of the trust are attributed to the settlor, who will be taxed accordingly. Distributions of the trust to the beneficiary are considered to be gifts and therefore income tax exempt.
In case of an irrevocable fixed interest trust the beneficiary is, from a Swiss tax law perspective, the owner of the assets and, therefore, he will in principle pay income taxes on the distributions. However, this will only be the situation if the income qualifies as taxable income under Swiss law and this qualification stays the same at the level of the beneficiary and the trust. For instance, capital gains of the trust distributed to the beneficiary, will not give rise to income tax as private capital gains are tax exempt. Also, no income tax is due upon the repayment of capital of the trust to the beneficiary.
Lastly, in case the settlor of an irrevocable discretionary trust is a Swiss resident, the tax treatment is similar as for a revocable trust. The income of the trust will be attributed to the settlor. However, if the settlor was a non-Swiss resident, then the assets of the trust can neither be attributed to the settlor nor to the beneficiary. Distributions from the trust to a Swiss resident beneficiary will qualify as income. The qualification is not the same at the level of the trust and at the level of the beneficiary. Therefore, distributions of capital gains will be taxable in the hands of the beneficiary.
As the decision to levy an inheritance and gift tax is in the competence of the cantons in Switzerland,[45] there is no harmonized tax treatment of the trust in this regard. Most of the cantons have abolished inheritance and gift tax where the beneficiary is a direct descendant. Thus, whether and to what extent a gift or inheritance tax is levied has to be decided on a canton-by-canton basis. The approach of the cantons as to what constitutes a gift and to whom is however similar. As the assets and income of a revocable trust are attributed to the settlor, distributions to the beneficiary are considered to be gifts. In the case of an irrevocable fixed interest trust, the beneficiary is likely to be regarded as having received a gift of the assets attributable to the beneficiary or a usufruct (capitalized earnings value). In the case of an irrevocable discretionary trust, distributions to the beneficiaries constitute gifts for Swiss fiscal purposes.

10. United Kingdom[46]

As might be expected, the UK has a highly sophisticated system with regard to the taxation of trusts where significant distinctions are drawn between:
- Discretionary and interest in possession trusts;
- Interest in possession trusts granted pre- and post- 22 March 2006;
- Testamentary and inter vivos trusts;
- Trusts in which the settlor retains an interest and those where the settlor is excluded from all benefit; and
- Trusts whose trustees are resident within and outside the UK.

Explaining the various permutations in detail is, of course, beyond the scope or purpose of this article and what follows is therefore only a very general overview.

42. Ruling V1999-08, 30 October 2008.
43. Thanks to Mrs. Weiss, kinga.weiss@walderwyss.com and Mr. Neidhardt, stephan.neidhardt@walderwyss.com.
44. 1 July 2007.
45. An initiative to introduce a federal estate tax in Switzerland has been filed.
46. Thanks to Mr. Eastaway, nigel.eastaway@mhllp.co.uk and Mr. Maston, ian.maston@gabelletax.com.

For newly created inter vivos trusts, where the trustees are resident in the UK *and* where the settlor (and his spouse or civil partner) is excluded from all benefit from the trust, the position can be summarised as follows.
The creation of the trust is immediately chargeable to inheritance tax at a rate of 20% subject to the availability of the settlors' Nil Rate Band exemption (currently £325,000, reviving every seven years).
Thereafter, the trust is subject to an independent inheritance tax regime whereby the trust assets are subject to inheritance tax every ten years (or when assets leave the trust – 'exit' charges) at, broadly, 6% (or a proportion thereof when assets leave) of their value in excess of the Nil Rate Band.
Any gains inherent in the assets being transferred to the trust can be 'held over' to the trustees. Gains can also be held over to the beneficiaries if capital assets are passed from the trust to the beneficiaries. If the trustees sell or otherwise dispose of assets they are subject to capital gains tax at 28%.
The income tax treatment is complex. Broadly, for a trust where the trustees have a discretion to distribute or accumulate income, income is taxed at the highest marginal rate – in most cases, 45%. Any income distributions from such a trust to a beneficiary, then carry a 45% tax credit and if the beneficiary's marginal rate is less than this, a repayment of the difference can be claimed from the tax authorities.
Again, very broadly, if an individual is entitled to a fixed right to income in a trust, he or she is taxable as if the income were his or hers (but with the trustees sometimes responsible for paying income tax at basic – which again gives rise to a tax credit for the beneficiary)
Important variations on the above tax treatment are as follows:
For some fixed interest trusts created by Will or created before 22 March 2006 (when there were significant changes in the inheritance tax treatment of trusts in the UK), the assets of a trust are treated as belonging to the beneficiary (to the extent of his or her interest). Thus, the ten yearly and exit charges do not apply, but the trust assets are instead taxable on the beneficiary's death.
Where the settlor retains an interest in a trust, the income of the trust is assessable on the settlor (the trustees may also be liable and this leads to some administrative complexity). The assets of the trust can also continue to form part of the settlor's estate for inheritance tax purposes under the 'gift with reservation of benefit' provisions – and this is *in addition* to the ten yearly and exit charges which would continue to apply. This double taxation is deliberate and is an attempt to deter the creation of such trusts.
In relation to trusts with non-UK resident trustees, there are more complex rules regarding the attribution of income to settlors or beneficiaries. There are also additional rules which can impute the capital gains of the trust – which are not taxable in the hands of the non-UK trustees - to the settlor or the beneficiaries. There are also additional rules which can impute the income and gains of underlying entities (e.g. non-UK companies) held by the trustees to the settlor or beneficiaries.
As can be seen from the above, therefore, the UK rules combine elements of independent taxation for trusts, with special rules which can apply to impose tax as if either the settlor or the beneficiaries were the owner of the trust assets. These rules have developed in a piecemeal fashion over a number of years – often driven by desire to deter avoidance by the UK government – and the final position is, as a result, extremely complicated and in many cases counter-intuitive.

11. United States[47]

There are two primary classifications of trusts that directly impact the U.S. federal tax treatment of such trusts. First, every trust is characterized for U.S. federal tax purposes as either domestic (*i.e.*, U.S.) or foreign.[48] Second, each trust is considered to be either a grantor trust or a non-grantor trust for U.S. federal income tax purposes. Each of these classifications in turn affects the taxation of the trust's income.
Where the "grantor trust rules" cause a trust to be classified as a "grantor trust" for U.S. federal income tax purposes,[49] the grantor is taxed annually on trust income as though he or she had retained direct ownership of the trust property rather than creating the trust and transferring the property to it. The grantor trust rules usually apply to a trust only to the extent that their effect is to cause items to be included in the income of a U.S. citizen or resident (or a domestic corporation). These rules broadly apply to U.S. grantors to treat trusts created by them as grantor trusts. On the other hand, a trust created by a nonresident alien grantor is treated as a grantor trust only if either the trust is revocable by the grantor, or the grantor and his or her spouse are the only permissible trust beneficiaries throughout the grantor's life. The grantor trust rules thus apply to a much narrower group of foreign trusts.
Distributions from grantor trusts are generally not taxable to the recipients, but instead are treated as gifts from the grantor.

47. Thanks to Mrs. Leigh-Alexandra Basha, leigh.basha@hklaw.com.
48. A trust is considered a U.S. domestic trust only if (i) a "court within the United States is able to exercise primary supervision over [its] administration" (the so-called "court test"); and (ii) U.S. persons have "authority to control all substantial decisions of the trust" (the so-called "control test"); if both of these requirements are not met, the trust in question is a "foreign trust."
49. These rules generally apply where the grantor retains certain significant control over, or beneficial interest in, the trust.

Trusts that are not subject to the grantor trust rules described above are classified as "non-grantor trusts" and generally have the effect of transferring tax liability away from the grantor to either the beneficiaries or the trust, depending on whether income is distributed to beneficiaries or accumulated in the trust. Non-grantor trusts are taxed in the U.S. in the same way as individuals are taxed. Thus, domestic trusts are taxable on their worldwide income regardless of its source or character and foreign trusts are typically subject to U.S. federal income tax only to the extent of any U.S.-source FDAP income[50] and ECI[51]. Foreign source income (including most capital gains) of a foreign non-grantor trust should therefore generally not be subject to any U.S. federal income tax in the hands of the trust (or its nonresident alien beneficiaries). Such trusts are, however, permitted to deduct certain amounts distributed to beneficiaries, who will instead be liable for the tax on such amounts. Thus, income of a non-grantor trust is taxed to beneficiaries if distributed to them currently, or instead is taxed to the trust if accumulated rather than currently distributed. If a foreign non-grantor trust does not distribute all its income currently, then upon distributions from such trusts to U.S. beneficiaries, an unfavorable set of provisions known as the "throwback rules" will apply to the receipt of any accumulated income by the beneficiaries.

For non-resident alien beneficiaries of a foreign non-grantor trust, if the foreign trust has U.S. source income that is subject to U.S. tax (*e.g.*, dividends from U.S. companies), such tax should be imposed by withholding in the U.S. on the amounts paid to the trust. However, if the trust distributes that income to the beneficiaries currently, then the trust may deduct the payment, thereby passing the U.S. tax liability on to the beneficiaries. This can be significant if, for example, the beneficiary's tax rate on such income is lower, pursuant to an income tax treaty between that person's country of residence and the U.S., than the rate of tax that would be imposed on the trust with respect to such item. In such cases, the amount initially withheld is applied as a credit against the tax determined to be owed by the beneficiary, with any excess being refunded to such person.

12. Concluding remarks

In this contribution, the tax treatment of trusts in nine contributing countries is discussed. Trusts can be used in practice as a very flexible and effective means of wealth accumulation and protection in an uncertain world.[52] However, from the above, we can draw the conclusion that rules – if any – on the taxation of trusts (and trust-like entities) vary considerably, even within the EU. It is remarkable that in some countries, for example in Spain and Italy, legal provisions on the taxation of trusts lack altogether. In these countries, the only guidelines as to the tax treatment of trusts are (limited) rulings issued by the tax authorities and case law.

As mentioned before, broadly speaking, two different systems can be recognized. First, the system wherein the trust is simply ignored for tax purposes (transparency approach), second, the system where the trust is considered a special purpose vehicle (entity approach). In this issue of WPNR the Dutch approach to trusts is discussed from various angles. When we compare the Dutch system of fiscal transparency to other countries, the most striking feature is that the Dutch methodology of transparency at the moment the settlor passes away, results in an allocation of the trust assets to the heirs of the settlor, who are not necessarily the same persons as the beneficiaries. As we have seen, this can be considered quite a unique approach, since most countries which apply a system of fiscal transparency primarily look at the beneficiaries.

Mention should be made of the exception applicable in the Netherlands to the basic principle that trust assets are allocated to the settlor during his life and thereafter to his heirs. When the heir can prove – by producing various documents – that he is not a beneficiary and never can become one, the allocation of the trust property to the heir will not happen. This rule shifts the burden of proof from the tax authorities to the taxpayer. Many writers consider this as one of the major disadvantages of the Dutch approach, since it may cause that the "wrong" person has to pay the tax.[53] Moreover, it is not hard to see that this specific approach may result in problematic outcomes as to double taxation issues. Despite this difficulty that has far-reaching consequences for taxpayers involved, the Dutch regime can also be described as consistent and relatively simple to apply.

Among the civil-law countries discussed, we recognize a common desire to prevent the use of sophisticated alien concepts, such as the trust, for merely tax avoidance purposes, even if those countries have signed the Hague Convention on the Law Applicable to Trusts.[54] Although this may lead to the recognition of the alien concept, the countries will nevertheless be able to deal with trusts in fiscal matters in the way they prefer. As we saw, the methods adopted by the countries discussed in this article, vary significantly. This greatly affects international clients and their advisers. A properly integrated international tax planning is therefore of paramount importance.

50. Fixed or determinable annual or periodical income, such as most dividends, interest, rents, and royalties.
51. Income that is "effectively connected" with the conduct of a trade or business carried on by the trust within the United States (such income is generally referred to as "ECI").
52. Eastaway, Richards and Kimber, Tax Advisers' Guide to Trusts, Bloomsbury Professional, Fourth Edition, 2010.
53. See e.g. J.P. Boer, *De Anglo-Amerikaanse trust in de inkomsten- en vennootschapsbelasting*, diss. Leiden, 2011.
54. Of the countries discussed in this article, the Convention is effective in Italy (as of 1 January 1992), the Netherlands (as of 1 February 1996), Switzerland (as of 1 July 2007) and the United Kingdom (as of 1 January 1992).