New Developments in the Treatment of Trusts in Belgium

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Belgium's Parliament adopted a law introducing a private international law code (code) in the Belgian legal system on July 16, 2004. The law was published in the official gazette on July 27.

Based on the scientific research of a group of professors of various Belgian law faculties, the code contains a comprehensive set of rules determining the international jurisdiction, the recognition, and the execution of foreign decisions and authentic instruments. It is the first complete and coherent codification of the Belgian Private International Law. The code will enter into force on October 1.

The Trust in the Private International Law Code

An interesting aspect of the code is that for the first time Belgian law deals with the concept of trusts, while Belgium has not yet signed the Hague Convention of July 1, 1985, on the Law Applicable to Trusts and on Their Recognition.

The following is an unofficial translation of the relevant provisions:

> Article 122. Characteristics of the trust.
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> For the purposes of this law, the term "trust" refers to a legal relationship created by an act of the founder or by a judicial decision, whereby assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose. This legal relationship has the following characteristics:
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> - the assets constitute a separate fund and are not a part of the trustee's own estate;
> - title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee; and
> - 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.
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> Article 123. International jurisdiction in respect of the trust.
>
> Section 1. The Belgian judge has jurisdiction to rule on any claim relating to the relationships between the founder, the trustee, or the beneficiary of a trust, except for the situations provided for by the general provisions of this law, if:
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> - the trust is administered in Belgium; or
> - the claim relates to assets located in Belgium at the time it is submitted.
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> Section 2. When the instrument setting up the trust gives jurisdiction to the Belgian judge or to the judge of a foreign State or to either, articles 6 and 7[1] apply by analogy.
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> Article 124. Law governing the trust.
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> Section 1. A trust shall be governed by the law chosen by the founder. The choice must be express or be implied in the terms of the instrument setting up or evidencing the trust, or the circumstances of the case. By exercising this choice, the founder can elect the law applicable to the entirety or a part only of the trust.
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> Where all significant elements of a trust, with the exception of the choice of law, are located in a state the law of which does not

[1]Articles 6 and 7 of the Law of July 16, 2004, deal with, respectively, the voluntary extension and exclusion of the international jurisdiction. Parties have the freedom in their choice of jurisdiction as to any existing or future claims resulting from a legal relationship. If they appoint a Belgian judge, the latter has exclusive jurisdiction. If the defendant appears before a Belgian judge, that judge will have jurisdiction unless the defendant appears only to refute his jurisdiction. Moreover, a judge can refuse his jurisdiction if the litigation has no significant connection with Belgium.

provide for trust, the choice shall not be effective.

Section 2. When the law applicable to the trust has not been chosen in accordance with Section 1 or when the chosen law does not validate the trust, the trust shall be governed by the law of the state where the trustee has his habitual residence at the time of its creation.

Until now, to understand the rules applicable to trusts, one had to analyze a limited number of court decisions.

Section 3. The application of the law governing the trust cannot deprive an heir from the indefeasible share to which the latter is entitled by the law that is determined in accordance with article 78.[2]

Article 125. Scope of the law governing the trust.

Section 1. The law governing the trust determines, in particular:

- the creation and the modalities of the trust;
- the interpretation of the trust;
- the administration of the trust, as well as the rights and obligations resulting from the administration;
- the effects of the trust; and
- the termination of the trust.

Section 2. This law does not govern the validity of the acts of acquisition or transfer of *real rights*[3] relating to the assets of the trust, nor the transfer of *real rights* relating to these assets, nor the protection of third parties acquiring these assets. The entitlements and obligations of a third party holding an asset of the trust continue to be governed by the law determined in accordance with chapter VIII.[4]

Although Belgium has not signed the Hague Convention of July 1, 1985, the text of those provisions was inspired by or even copied from the text of the convention. However, they are tainted by the notions of civil law and by specific concepts under civil law.[5]

Those four provisions of the code clarify the rules laid down by the courts. Indeed, until now, to understand the rules applicable to trusts, one had to analyze a limited number of court decisions.

- In a decision dating back to 1947, the Brussels Civil Court[6] decided that the deceased, being an English national, had validly chosen an English trust. This choice was perfectly valid and, therefore, the court held that the trust was valid and not contrary to the Belgian Public Order.
- The Court of First Instance of Antwerp[7] confirmed the settlor's freedom of choice. The deceased settlor had instituted a foreign trust by will, the only Belgian dimension of which was that the trust assets included two properties in Belgium.
- This was again confirmed by the Brussels Court of First Instance[8] in a case of a British lady who had acquired Belgian nationality through her marriage to a Belgian national. She had set up a (testamentary) trust in accordance with the laws of Monaco, where she eventually died. The court held that the deceased was allowed to set up a trust by reference to her British nationality. However, it decided that the effects of the trust had to be restricted by the forced heirship rules. The court explained that it tried to balance the will of the deceased and the Belgian inheritance rules and that it resulted in an equitable solution for the daughter.

The conclusion was that the courts would normally uphold the settlor's freedom to choose to set

[2]Article 78 of the Law of July 16, 2004, provides that the succession is governed by the law of the state where the deceased had his ordinary residence at the time of his death. The exception is real property for which the situs of the assets determines the governing law, unless the foreign law refers back to the law of the ordinary residence of the deceased.

[3]*I.e., "droits réels"* or rights *in rem.*

[4]Chapter VIII deals with the private international law aspects of goods: international jurisdiction; governing law; and enforcement of foreign judicial decisions.

[5]*E.g.,* the use of a word like "founder" instead of "settlor" refers to the Belgian notion of the founder of a foundation. The government introduced an amendment to refer in the second paragraph to the *real rights* on trust assets, rather than to the ownership right. Envisaging a division of the ownership right under civil law into bare ownership and a *real right*, such as *usufruct*, seems incompatible with the fundamental distinction between legal and beneficial ownership rights under trust law.

[6]Trib. civ. Bruxelles, November 27, 1947, *Pasicrisie,* 1949, III, 57.

[7]Trib. civ. Antwerp, March 4, 1971, *Receuil Général de l'Enregistrement et du Notariat,* nr 21.475, p. 251.

[8]Court of First Instance, Brussels, May 31, 1994, *Rechtskundig Weekblad*, 1994-1995, 677.

up a trust organized under a foreign legal system, but that they would weigh that against certain statutory restrictions regarding the Belgian public order. I have always had reservations about that case law.[9] The courts never had to decide a case involving a trust without any foreign dimension. If a Belgian settlor were to create a trust for his Belgian assets while he is a resident in Belgium, it was unlikely that the courts would accept that he has the same freedom of choice.

Those four provisions in the code have the advantage of clarifying several issues. First, they define the trust in a manner that is consistent with the definition proposed by the Hague Convention (article 122). The code gives the Belgian courts jurisdiction over any claims regarding a trust administered in Belgium or trust assets located in Belgium (article 123). However, the Belgian judge must respect the settlor's choice of law as long as he has not deprived one of his heirs from the share of his estate that is reserved for the latter by the law of the settlor's domicile. And when the settlor has chosen the governing law, article 125 determines which aspects of the trust will be governed by the trust. That is stated in wider terms than in the Hague Convention, but the effect will normally be the same. Nevertheless, the acquisition or the transfer of the trust assets or the protection of third parties who acquire trust assets will not be construed under the law governing the trust.

The code goes further than just confirming the settlor's freedom of choice. It certainly does not prevent a Belgian settlor from creating a trust. To the contrary, these provisions imply that he would be able to. However, what a Belgian settlor would not be able to do is set up a trust under Belgian law, because the assets must constitute a separate fund apart from the trustee's own estate and that does not seem possible under Belgian law.[10]

The settlor's freedom could, nevertheless, be restricted by the limitations of the Belgian public order (see also articles 20 and 21 of the law of the code) and, in particular, those on the Belgian inheritance rules (article 124, section 3).

Moreover, the courts can invoke *fraus legis*. "When determining the governing law in a situation where parties are not free to dispose of their rights, facts and transactions that occurred with the only purpose to escape the application of the law to which the code refers are disregarded" (article 18). Furthermore, the law referred to by the code can also be disregarded if the connection with the state in question is tenuous (article 19).

Tax Regime of the Trust Under Belgian Law

Belgian tax law does not deal with trusts. To determine how trusts are treated under Belgian law, one must analyze the situation under Belgian civil law. However, Belgian civil law does not distinguish between beneficial and legal ownership. The different transactions and legal relationships, as well as the respective rights and obligations of settlor, trustee, and beneficiary must therefore be translated into terms of Belgian civil law before the Belgian tax rules can be applied. The tax law therefore follows the civil law. That also means that the tax regime depends on the content of the trust deed.

When analyzing the trust, Belgian commentators have generally simplified the perception of the trust concept into two extremes: the fixed interest trust and the irrevocable and discretionary trust.

If the settlor has set up a fixed interest trust, the trust should be treated as transparent for tax purposes. That means that when the settlor transfers assets to the trustee, the trustee receives them as a nominee for the beneficiary. This analysis is obvious if the settlor is also the beneficiary of the trust.

To determine whether any tax is due, the tax authorities disregard transfers of assets or payments to the trustee and examine their effects as if those assets or payments were made directly to the beneficiary, at least after he accepts the benefit of the transfer or payment.

The trustee may need to declare the income if it is liable to tax in Belgium. However, the Belgian beneficiary has no obligation to declare any benefits he receives from the trust.

If the trust is a fixed interest trust, the beneficiary receives the income from the trust assets. The income may be liable to income tax as investment income at 25 percent or 15 percent, depending on the nature of the income.

If, however, the trust is irrevocable and discretionary, the trustee decides unilaterally if and when he grants a benefit to the beneficiary and what the extent of the benefit is. That means that it is the trustee who collects the trust income and that any gratuities granted to the beneficiaries would be nothing but a gratuity. The tax authorities cannot disregard any transfers of assets or

[9]Quaghebeur, M. "Trusts in Belgium," in *Transcontinental Trusts*, London, Monitor Press Ltd, 1997, p. 127.

[10]Except maybe in the form of a Belgian private foundation.

payments to the trustee or their effects. And any transfers or payments by the trustee to the beneficiary must be seen in light of the particular relationship between a trustee with discretionary powers and a beneficiary.

Therefore, it is the trustee under an irrevocable and discretionary trust who may need to declare the income if it is liable to tax in Belgium. The Belgian beneficiary, however, does not have an obligation to declare any benefits he receives from the trust on his income tax return, because pure gratuities or donations are not taxable income.

That analysis has been corroborated by a provision[11] that was introduced during the introduction of the concept of certification of shares in Belgium in 1998. The legislation was heavily inspired by the concept of certification as it exists in the Netherlands and, in particular, the certification of stock via a so-called administration office (*administratiekantoor*).

From a tax perspective, the certifying entity is treated as fiscally transparent as long as the certifying entity — usually a private foundation, or administration office — immediately distributes the income from the shares.[12] The certificates are assimilated to the underlying shares and the certificate holder to a shareholder. In other words, the certificate holder is the direct beneficiary of the dividends and of any other distributions. On the contrary, if the income is not distributed immediately, the certifying entity remains the real shareholder and any later payments by the certifying entity should be treated as interest instead of dividends.

If the certifying entity is transparent for tax purposes, whether the company paying the dividends has to withhold tax at source on the dividends depends on the certificate holder's situation. Capital gains realized by the shareholder at the time of the certification or the cancellation of the certification[13] remain tax-exempt. If the certificate holder is a company, the capital gain realized at the time of the certification is tax-exempt, while capital losses are not deductible for corporate income tax purposes. Any capital gains realized on a sale of the certificates, however, are calculated in function of the acquisition value of the certified securities.

Another important precedent that supports that analysis is the set of decisions handed down by the Netherlands Supreme Court on November 18, 1998, on the nature of a gift to an irrevocable discretionary trust. (For prior coverage, see *Tax Notes Int'l,* Apr. 8, 2002, p. 73.) Under Netherlands law, gifts are subject to tax if there is an impoverishment of the donor, an enrichment of a donee, and an intention to make a donation. The Netherlands Tax Court had decided that there was no donee, because at the time of the gift, no party was definitely "enriched" by the donation. It considered that the trustees were free to decide whether to make distributions to the beneficiaries. The protector of one of the trusts was entitled to appoint other beneficiaries in addition to or instead of those mentioned in the trust deed.

The Netherlands Supreme Court overruled that decision. It held that because the trusts were irrevocable and discretionary, the settlement of the trusts did not give the settlor, trustee, protector, or beneficiaries any direct entitlement to the assets of the trust from which they could derive an equity value. Although some of the individuals and entities may have expected to obtain those assets in the future (the beneficiaries), or may have had a certain amount of control over the assets (the protector), none had legal ownership over the trust assets. Consequently, the Court concluded that neither party could be subject to gift tax on the trust's assets.

More importantly, the Court held that although the transfer of the assets to the trust was not a donation by the settlor to the beneficiaries, the settlor, nevertheless, had disposed of his assets. The Court considered that the trust constituted a separate fund and therefore a separate entity for Netherlands tax purposes. Consequently, the trust was considered to be the donee for gift tax purposes. The result was that gift tax was due by the trust at the (highest) rates applicable to gifts made to nonrelatives.[14]

That decision of the Netherlands Supreme Court does not have any direct legal effect in Belgium, but its influence by way of precedent must not be underestimated.

The introduction of the code is not likely to change anything substantial in the tax treatment of the trust in Belgium. It will, however, take away a number of uncertainties and objections that the Belgian tax authorities might raise against the trust. ✦

[11]Article 13 of the Law of July 15, 1998, on the certification of securities issued by commercial companies.

[12]Generally speaking, within 15 days.

[13]*I.e.*, the conversion of the certificates back into the shares they represent.

[14]Following this decision, the Netherlands vice minister of finance published a decree on February 10, 2000, on the tax treatment of trusts, allowing taxpayers to obtain advance guidance on the Netherlands tax treatment of various types of trusts. (For prior coverage, see *Tax Notes Int'l*, Mar. 6, 2000, p. 1049.)