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## Authorities Clarify Gift and Inheritance Tax Rules for Trusts

by Marc Quaghebeur

In late 2004, Belgian tax authorities clarified their position on the gift tax and inheritance tax liability of discretionary trusts. The summary of that decision (Decision E.E./100.383, Dec. 20, 2004) was published recently on the Finance Ministry's Web site (<http://www.fisconet.fgov.be>).

### Trusts Under Belgian Law

Until the Belgian Parliament adopted the Private International Law Code (July 16, 2004) (for prior coverage, see *Tax Notes Int'l*, Sept. 27, 2004, p. 1207), the appropriate tax treatment of a trust under Belgian tax law was never clear. Any analysis was based on three decisions by the Brussels and Antwerp courts of first instance.<sup>1</sup> The consensus was that the courts would uphold the settlor's freedom of choice to set up a trust organized under a foreign legal system, but that they would weigh that freedom against statutory restrictions regarding the Belgian public order.

The Private International Law Code now defines a trust roughly in accordance with the definition in the Hague Convention of July 1, 1985, on the Law Applicable to Trusts and on Their Recognition. The code confirms the settlor's freedom of choice, assuming he does not choose the law of a jurisdiction that does not have a trust concept or does not deprive one

of his heirs from the share of his estate that is reserved for him by the law of his own domicile. When the settlor has chosen the governing law, the code determines which aspects of the trust will be governed by the trust.

The code also limits the settlor's freedom of choice. The limitations concern the Belgian public order and the Belgian inheritance rules, or *fraus legis* (abuse of law). A trust cannot be set up under Belgian law, and Belgium can disregard the choice of jurisdiction if the connection with that jurisdiction is tenuous.

However, the Private International Law Code confirms that the assets constitute a separate fund under the control of a trustee. In other words, the code confirms that the trust assets are not part of the trustee's estate, though they need not be owned by a body corporate.

### Tax Regime

The difficulty with trusts has always been in determining how they are to be treated under Belgian law. Belgian civil law does not have a trustlike concept whereby assets are held by a person in a manner in which the legal ownership of assets is separated from the beneficial ownership.

And because tax law follows civil law, the transactions and legal relationships resulting from a trust had to be translated into civil law terms before the Belgian tax rules could be analyzed. When analyzing a trust, Belgian commentators decide if it is a fixed-interest trust or an irrevocable and discretionary trust.

<sup>1</sup>Trib civ Bruxelles, November 27, 1947, *Pasicrisie*, 1949, III, 57; Trib civ Antwerp, March 4, 1971, *Receuil Général de l'Enregistrement et du Notariat*, no. 21,475, p. 251; Court of First Instance, Brussels, May 31, 1994, *Rechtskundig Weekblad*, 1994-1995, 677.

The trustee of a fixed-interest trust is seen as a nominee for the beneficiary, particularly when the beneficiary accepts the benefits of the trust. Therefore, the trust is treated as transparent for tax purposes. During the settlor's life, the assets are deemed to have remained in his estate, and he continues to be taxed on any income generated by the trust assets. To determine whether tax is due, the tax authorities disregard any transfers of assets or payments to the trustee and examine their effects as if the assets or payments were made directly to the beneficiary, at least after the benefit of the transfer or payment is accepted.

That analysis is obvious if the settlor is also a beneficiary of the trust. Generally, the settlor is deemed to continue to receive the income from the trust assets, and that income normally is subject to income tax as investment income at a rate of either 25 percent or 15 percent, depending on the nature of the income.

When a third party receives a benefit from the trust, the situation must be examined from the standpoint of the relationship between the settlor and the beneficiary. If the receipt occurs during the settlor's lifetime, it may constitute a gift and gift tax may be due, but only if the donation must be registered. Typically, however, a trust is used to bestow benefits to beneficiaries upon the settlor's death. If the beneficiary accepts entitlements at that time, the benefits are added to the estate of the deceased settlor and the beneficiary is subject to inheritance tax. Under the antiavoidance rule of article 7 of the Inheritance Tax (IHT) Code, that would also be the case for any entitlements accepted during a three-year period before the settlor's death.

Tax transparency means a fixed-interest trust is of limited use for estate planning. An irrevocable and discretionary trust overcomes those obstacles. The trustee decides unilaterally if and when he grants the beneficiary any entitlements and what the extent of those entitlements will be. It is the trustee who collects the trust income, and any gratuities granted to the beneficiaries are considered pure (tax-free) gratuities.

However, tax authorities cannot disregard any transfers of assets or payments to the trustee. Those can be seen only in light of the relationship between a trustee with discretionary powers and a beneficiary.

Therefore, it is the trustee who may need to declare the income if it is subject to tax in Belgium. The Belgian beneficiary, on the other hand, has no obligation to declare any benefits received from the trust, because pure gratuities or donations are not taxable income.

However, gift tax may be due on benefits granted by the trustee, if the beneficiary has accepted them and if the transfer of the benefit must be registered to take effect. That would be the case, for example, if the trust assets include real estate located in Belgium.

If the trust is set up at the death of the settlor, the entitlements received by the beneficiary are subject to inheritance tax. However, the tax is due only when the beneficiary obtains a benefit from the trust.

Inheritance tax is due on the net value of the estate of the deceased (that is, the gross value less the liabilities of the deceased). However, some assets that have left the settlor's estate must be added back into the estate. That applies to lifetime gifts made by the deceased less than three years before death (article 7, IHT Code), unless gift tax was paid, and to entitlements granted to a third party as a condition in a contract concluded by the deceased (article 8, IHT Code). Unless gift tax was paid, any capital paid out under a life insurance contract, or any entitlements granted by a trustee appointed by the settlor, will be clawed back into the settlor's estate and will be subject to inheritance tax.

### Tax Authorities' Position

The tax authorities have confirmed that at the time of the settlement of an irrevocable discretionary trust, no gift tax is due by either the trustee or the beneficiary; the trustee is not the beneficiary, because the trust assets go into a separate fund apart from the trustee's own estate, so the trustee derives no benefit from the trust. And the beneficiary has no gift tax liability at the time the trust is settled because the trust assets are not transferred immediately and irrevocably into the beneficiary's possession. As long as the beneficiary does not accept the benefit of the donation, there cannot be any donation. And even when the beneficiary accepts the donation, the gift tax will be due only when the benefit is received.

As for inheritance tax liability, the tax authorities confirmed that the beneficiary's entitlement is at the discretion of the trustee, so the entitlement remains uncertain at the time of the settlor's death. As long as the trustee does not decide that the beneficiary is to receive a benefit, and what the extent of that benefit will be, the beneficiary cannot be subject to inheritance tax. That tax can become due only when the decision to grant an entitlement is made. ♦

♦ *Marc Quaghebeur, Vandendijk & Partners, Brussels*