INCOME TAXATION OF TRUSTS IN BELGIUM

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INTRODUCTION

Trusts do not exist under Belgian civil law. However, trusts governed by foreign law are generally analyzed by applying conflict of law rules. As a result, Belgium will generally recognize trusts formed under applicable foreign laws. In Belgium, trusts can be subject to both income tax and gratuitous transfer taxes (by reason of death or *inter vivos*). This article only focuses on income tax issues.

INCOME TAX ISSUES

The Belgian income taxation of trusts is governed by the "Cayman Tax" law ("C.T.L.") enacted in 2015. The C.T.L. has introduced "pass-thru" tax treatment of income generated through foreign private wealth structures referred to in the law as "legal constructions" (and as "Type 1" entities in practice – see below). Trusts fall within this definition. The law also applies to low-taxed foundations and offshore companies (referred to as "Type 2" entities – see below) but in a different way as it does to trusts.

The C.T.L.[1] is applicable as of January 1, 2015,[2] and has been amended by a law dated December 26, 2015.[3] Prior to the C.T.L., another set of rules applied to trusts. While, no specific Belgian law dealt with the treatment of trusts, foreign trusts were analyzed based on scholarly articles and case law, including several decisions by the Federal ruling commission. The author is of the view that the C.T.L. replaces prior practice, although differing opinions exist.[4]

Pursuant to the C.T.L., income tax may be imposed on the "Founder(s)" of a trust or on "Third-Party Beneficiaries," depending on the applicable facts. Prior to this legislation, a 2013 law required Belgian-resident Founders and Belgian-resident Third-Party Beneficiaries to disclose the existence of a trust on their annual income

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1 Program Law 10 August 2015, art. 38–47, Chamber of Parliament Doc. 54 1125/001-021, Belgian Official Journal (August 18, 2015), ed. 2.

2 For a full analysis see Gerd D. Goyvaerts, "*De Kaaimantaks, Een Kritische Benadering*," T.F.R. 490-491 (2015), pp. 865–923 (article in Flemish); Valérie-Anne De Brauwere and Christelle Wils, "*Taxe Caïman, Le Crocodile aux Dents Longues*," *Wolters Kluwer* Revue Générale de Fiscalité 8 (2015), pp. 5–23 (article in French).

3 Law of 26 December 2015, B.O.G., (December 30, 2015).

4 For an extensive comment on the "old regulations" see Gerd D. Goyvaerts, "The Tax Aspects of the Use of Foreign Trusts in Belgium for Private Wealth Purposes," *The Journal of International Tax, Trust and Corporate Planning* 2011, p. 267.

tax returns.[5] This reporting allows the Belgian tax administration to gather trust-related information and assess tax on trust income, and the C.T.L. has been drafted with the same purpose in mind.

At first glance, the C.T.L. may appear to be a useful legal instrument in the fight against the fraudulent or abusive use of trusts. However, the C.T.L. does generally not take into account the complexity of internationally structured estates and the wide variety of reasons why an individual may wish to use a trust structure in another jurisdiction – be it low-tax or not. While families often seek practical solutions to civil, corporate, or common law issues, these answers cannot always be found under Belgian law. Hence, families may turn to trust indentures to achieve stability in an uncertain financial environment generated by the internationalization of family ties.

Other statements in the C.T.L. parliamentary documents reflect a general lack of knowledge regarding trusts, including the discretionary character of certain trusts. Although this misconception served as the parliamentary basis for taxing the international wealth of Belgian citizens involved with trusts, the C.T.L. is more accurately viewed as a matter of tax policy and a reflection of Federal budget considerations.

Nonetheless, the Belgian Parliament must respect international tax treaties and E.U. and European Economic Area ("E.E.A.") regulations, as well as regulations that pertain to the resolution of international conflicts of law. It remains to be seen whether the C.T.L. Tax fully conforms to these rules. Notably, the C.T.L. produces several adverse tax consequences relating to retroactive double taxation. The most important of these is that the C.T.L. does not allow for relief from double taxation where foreign taxes are paid on trust income, a significant issue when the new legislation is applied to an existing trust structure.

Trusts as Legal Constructions (Type 1 Entities)

The C.T.L. applies to trusts, yet it does so under a specific legal definition without referring to the notion of a "trust" or "trust law." Instead, the law refers to a very broad definition of a Type 1 legal arrangement that includes trusts.[6]

Since trusts are not known under Belgian tax or civil law, they have been defined as "legal relationships/arrangements" based on the general look and feel of the Anglo-Saxon trust. The term "legal relationship" is inspired by the definition of a trust as used in the Belgian Code on International Private Law ("B.I.P.L."), which contains the codification of Belgian conflict laws.

The translated Flemish text provides the following definition of "trust" (*i.e.*, a Type 1 entity):[7]

> Legal relationship(s) created by an act of the founder or by a court order, by which assets are placed under the control of a trustee in

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[5] Gerd D. Goyvaerts, "Belgium: A New Obligation to Declare Foreign Private Wealth Structures," *The Journal of International Tax, Trust and Corporate Planning* 2014, p. 64.

[6] Article 2-§1-13° of the Belgian Income Tax Code ("B.I.T.C.").

[7] Note that in the translation the word "trustee" is used, although the law refers to *beheerder* or *administrateur*. One may therefore also use the term "administrator." There is no reference whatsoever to "trust law."

order to be administered for the benefit of one or more beneficiaries or for a certain purpose. This legal relationship presents the following characteristics:

1. the property title to the assets of, or to the entitlements from, the ‘legal construction’ is drafted in the name of the trustee or in the name of another person on behalf of the trustee;

2. the assets of the ‘legal construction’ form a separate estate and are not part of the estate of the trustee;

3. the trustee has the authority and the duty, in respect of which he is accountable, to manage, administer or dispose of the goods in accordance with the provisions of the legal construction and the special duties imposed by law on the trustee.

Trust-like arrangements are within the scope of this Type 1 designation, regardless of the level of tax incurred.

“Since trusts are not known under Belgian tax or civil law, they have been defined as ‘legal relationships/ arrangements’ based on the general look and feel of the Anglo-Saxon trust. ”

Exclusions from Pass-thru Treatment (Article 2-§1-13°/1 B.I.T.C.)

The C.T.L. provides a list of entities that are excluded from pass-thru treatment. In order to be so excluded, the listed entities must meet certain requirements. Although these exclusions may also apply to trusts, they have not been designed for trusts as such. Pension trusts or trusts designed to hold employee stock participations (defined as “settlements for the financing of legal or additional retirement payments”) are generally excluded entities; however, the analysis is made on a case-by-case basis.

The Substance Exemption (Article 5/1-§3(b) B.I.T.C.)

The substance exemption provides criteria for a trust to be outside the scope of the C.T.L. This exemption was inserted to improve compatibility with E.U. and E.E.A. regulations, following the Court of Justice of the European Union’s (“C.J.E.U.’s”) decision in *Cadbury Schweppes Plc v. Revenue and Customs Commissioners*[8] and the E.F.T.A. Court’s judgment in Olsen.[9]

Under this exemption, the Founder and/or Third-Party Beneficiary can avoid pass-thru treatment by showing that the trust meets a substance test, *i.e.*, that it is not a “wholly artificial arrangement” and that it has a “genuine economic activity” based on “objective factors[,] which are ascertainable by third parties.” These factors include “offices, staff[,] and equipment which stands in relation to the mentioned genuine economic activity.” It is unclear what proof will be accepted by the tax authorities. On one hand, it may be expected that a trust that merely controls a holding company would not require as many offices and staff as a company providing services in the course of an active business. On the other hand, proving when a genuine economic activity exists in a specific case will likely be a difficult undertaking.

The substance exemption is available for all trusts formed in the E.E.A. and/or

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[8] *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, No. C-196/04 (2007), at ch. 30.

[9] *Fred. Olsen and Others v. the Norwegian State*, No. E-3/13 and No. E-20/13 (July 9, 2014).

countries with which Belgium has concluded a double tax treaty ("D.T.T.") or Tax Information Exchange Agreement ("T.I.E.A."), including a bilateral or multilateral agreement in relation to which tax information can be exchanged on request. In light of recent developments regarding exchange of tax information, a large number of offshore trusts may theoretically claim this exemption. However, it remains to be seen to what extent invoking the substance exemption and claiming real economic activity may give rise to adverse tax consequences in the country of establishment.

To meet the substance test, substantial verifiable evidence must be provided. One should expect the highest level of scrutiny to be applied by the tax authorities. In that respect, the Belgian Parliament has indicated that the substance exemption cannot be claimed by trusts that "limit their activities solely to the management of private wealth." It is however highly questionable whether this limitation on the substance exclusion would stand up to a challenge before the E.F.T.A. Court or the C.J.E.U.

The substance exemption is not automatic and must be claimed on a Belgian tax return. As a result, claiming the exemption does not relieve the taxpayer from Belgian filing obligations, which are intended to increase transparency, and noncompliant taxpayers cannot attribute non-filing to the application of the substance exemption.

Founders

The C.T.L. provides for tax transparent treatment of the trust instrument. Thus, trust income is taxed as if directly received by the Founders, irrespective of actual distributions. Certain qualifying trust distributions may also be taxable in the hands of Third-Party Beneficiaries. This combination of both potentially taxable distributions and pass-thru taxation makes the application of the C.T.L. quite complex.

With regard to trusts, the law lists three types of Founders in Article 2-§1-14° B.I.T.C.:

- The individual who settled the trust outside the course of his or her professional activities
- The individual who, outside the course of his or her professional activities, contributed assets and "entitlements" to a trust settled by a third party (including also a declared trust)
- The "Founder by Heirship," *i.e.*, an individual who is the direct or indirect heir of one of the above-mentioned individuals (from the death of the latter onwards, unless the heir provides proof that neither they themselves nor their issue, will benefit at any time nor in any way from financial, or other, benefits granted by the trust)

The definition of Founder by Heirship is intended to be as broad as possible, encompassing several future generations of potential beneficiaries. The legislative intent here is to prevent the application of an old 1962 High Court case that excluded heirs from a comparable anti-abuse rule related to income taxes.

As an example of a (potential) heir, parliamentary documents cite a person who is to receive a benefit from a trust upon a certain condition (*e.g.*, reaching a certain age – which is common practice in many trust instruments). The example further provides that the existence of a condition will not preclude the heir from being considered a

Founder, which will lead to the transparent taxation of income received by the trust, regardless of any actual distribution. Every individual who is entitled by legal heirship to a part of the estate of the initial Founder is considered to be an heir for C.T.L. purposes. This is the case regardless of otherwise applicable intestate inheritance laws or the presence of a will or testament.

Any legal heir of the Founder can avoid being qualified a Founder by showing that he or she cannot, nor did, receive any financial or other benefit from the trust. This may be virtually impossible to prove, since one may never exclude receiving a voluntary entitlement from a trust established by ancestors, especially if it is administered by an independent discretionary trustee. However, solutions are available to prevent taxation without having received any economic benefits.

Based on the parliamentary documents, it appears that a Belgian taxpayer may avoid Founder status by irrevocably renouncing any benefit from the trust and providing a letter of the trustee stating that neither that person nor his or her heirs can ever, at any point in time, receive in any form or way any benefit from the trust. The explanatory memorandum to the law specifies that the tax authorities will in principle accept such a letter as proof. However, should it appear that such a letter does not reflect reality, the tax authorities may invoke the offence of forgery of fiscal documents against the Founder who used the letter, as well as against the legal construction that issued it. In particular, trustees of a discretionary trust should consider to what extent they are able to provide such assurances prior to the issuance of a letter.

Third-Party Beneficiaries

According to the definition under Article 2-§1-14°/1 B.I.T.C., Third-Party Beneficiaries are individuals who, at any given moment and in any given manner, effectively receive (taxable) benefits allocated by a trust. It can be argued that only an actual distribution of a benefit triggers C.T.L., along with the qualification of Third-Party Beneficiary. Hence, any reporting obligation and/or taxability depends thereon. This is relevant for beneficiaries of a trust of which the settlor is still alive. These persons will have no reporting obligations in Belgium, as long as they do not receive an effective distribution.

It is also possible that the same taxpayer can be seen as both a Founder and a Third-Party Beneficiary in the same tax year. This will mainly be the case when an entity within the scope of the C.T.L. makes a distribution to a Founder.

Pass-thru Taxation of Trust Income

The C.T.L. provides for pass-thru treatment of trust income. As a result, income from a trust is generally taxed in the hands of the Founders, and the trust is disregarded as a separate entity for Belgian income tax purposes. This means that the underlying income retains its original qualification and no effective distribution is required for taxation to occur.

Do note that this regime is not limited to merely "passive income." One example of applicable income might be a consultancy fee received by a trustee of a trust settled by a Belgian tax resident. It is unclear how the application of pass-thru treatment will interact with the previously mentioned definitions of Founder. Indeed, individual Founders will, in general, only be individuals that established an eligible

entity outside the course of their professional activities. On the other hand, mere shareholders are also seen as Founders under a distinct fourth category, which falls outside the scope of this article.

Under the C.T.L., interest received by the trust remains interest, dividends remain dividends, and capital gains remain capital gains. The first two categories of income are generally taxed at a flat 30% tax rate in Belgium (rate as from January 1, 2017). Capital gains on movable assets realized by a private individual are generally tax exempt under Belgian tax law, to the extent that they are realized within the course of the normal management of a (private) estate. Taxation of so-called miscellaneous income at 33% may occur. Parliamentary documents confirm that capital gains realized through a trust, are (in principle) deemed to qualify as capital gains realized within the course of the normal management of a (private) estate.

The investment policy undertaken by the trustees may therefore be highly relevant from a Belgian tax point of view. Indeed, to the extent the trustees invest in assets generating tax-exempt income for Belgian tax purposes, the investment policy could be beneficial, even under the C.T.L. Tax-exempt income that is attributed or distributed to a Founder or Third-Party Beneficiary may also, as a general matter (and provided certain timing requirements are met), remain tax exempt under the C.T.L.

The parliamentary documents state, "It is self-evidently [sic] that [the] Cayman Tax has to take into account the double tax treaties [D.T.T.] concluded by Belgium." For example, in cases of foreign real estate income, the D.T.T. generally attributes the right to tax to the partner state. As a result, no Belgian income tax can be levied under the C.T.L. All this is to be verified in detail, based upon the specific facts of the case at hand.

"To the extent the trustees invest in assets generating tax-exempt income for Belgian tax purposes, the investment policy could be beneficial."

Where there is a multitude of Founders, each Founder is taxed in proportion to his or her contribution to the assets held in trust. If their respective shares cannot be determined, each Founder is allocated an equal part of the assets held in trust. This may lead to disputes and difficulties in practice. It may prove difficult, for instance, when grants and settlements took place a long time ago, thus making it almost impossible to re-establish the origins of the funds.

Founders by Heirship are taxable in proportion to "their share" in the trust or, if this cannot be proven, in proportion to their part in the hereditary succession of the Founder to whom the individual is heir. Valid proof to the contrary can be provided by the heirs. This may also lead to difficulties in practice.

Take, for instance, the case where a Belgian-resident father is the Founder of a trust. He leaves two-thirds of the estate to his son and daughter by last will and testament and transfers the other one-third of the estate more than three years prior to his death. The son and daughter are both beneficiaries of the trust. According to the trust deed and in practice, it remains wholly in the trustees' discretion to decide if and to what extent the children will or will not receive distributions of income and/or capital. In the example, the trustee decides not to make distributions within the first five years after the death of the father (Founder). In these five years, both the son and the daughter will be taxable on half of the income received by the trust, given their equal entitlement to the estate of the father. If the trustee decides after five years to distribute 90% of the total of assets only to the daughter, for whatever reason, the son will have been liable to tax on income he never received.

Parliamentary documents also give a comparable example, from which it appears that qualifying Founders remain taxable under the pass-thru tax regime, even though (i) they never received any actual distribution out of a trust and (ii) distributions were made to Third-Party Beneficiaries.

As indicated above, the parliamentary documents do mention the possibility for Founders by Heirship to demonstrate that they will never benefit from a trust, via a letter sent by the trustees. The Belgian tax administration will, in principle, accept such a letter as means of proof. Self-evidently, such a letter must reflect a genuine and irrevocable exclusion or removal from entitlement for the taxpayer and his or her heirs.

"When 'past income' is distributed to a Third-Party Beneficiary, no taxation will occur."

To the extent a Founder can demonstrate that income obtained by the trust has been effectively distributed to a Third-Party Beneficiary, who is a Belgian tax resident or tax resident of a qualifying country, this income will not be taxable in the hands of the Founder. However, such proof can only be given for income received and distributed in the income year itself.

Indeed, when "past income" is distributed to a Third-Party Beneficiary, no taxation will occur since the tax will already have been paid by the Founder.[10] No tax credit or claw back can be claimed in such cases. This is the so-called X–(X+1) rule – where "X" refers to the income year and "X+1" refers to the year in which the income has been distributed – also referred to as the "Current Income Year Principle." This principle is not described as such in the wording of the law, though the parliamentary documents apply the rule in several examples given, and the Minister of Finance has also confirmed its application in a reply to a parliamentary question. The Current Year Income Principle has also been described in a number of very recent tax rulings that were issued in November of 2016.

The following example best illustrates this principle. A father sets up a trust in 2005 for the benefit of his two children, X and Y, as well as his friend, Z. All are Belgian tax residents. The Belgian father passes away in 2012. Until 2015, the trust received €100,000 in capital gains and €100,000 in dividends. In 2015, the first year to which the C.T.L. applies, the trust received €20,000 in capital gains (tax exempt for Belgian individual income tax purposes, to the extent they are realized within the "normal management of a private estate") and €20,000 in dividends. Since X and Y can be qualified as Founders by Heirship, they are taxable under the C.T.L. on the €20,000 in the dividends. The same facts apply to 2016 and 2017. At the end of 2018, the trustees wish to make a distribution of €100,000 to Z. This distribution is financed by dividend income (€20,000) and capital gains (€20,000) received by the trust in 2018, and by income received in the past by the trust (€60,000). For 2018 (*i.e.*, tax year 2019), X and Y will most likely be able to demonstrate that Z received the €40,000 in dividends and capital gains. Hence, Z will be taxable as a Third-Party Beneficiary under the C.T.L. for the €20,000 in dividends. The capital gains remain tax exempt. In this example, the Belgian-resident children, X and Y, will have to pay tax on income they will never receive and which is finally attributed to Z.

As mentioned earlier, Belgian-resident Founders can provide valid proof to the contrary. This proof will require that the Third-Party Beneficiaries are resident in Belgium, another E.E.A. country, a country with which Belgium has a treaty containing

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[10] Article 5/1-§1 B.I.T.C.

an exchange of information provision, or a country with which Belgium has a T.I.E.A. in place. Useful to note here is that since 2009 Belgium has entered into agreements for the exchange of information with many countries, including several offshore jurisdictions. According to the parliamentary documents, the possibility of exchanging information is sufficient. An actual exchange is not necessarily required.

Specific Anti-Abuse Regulations Do Not Genuinely Apply to Trusts[11]

The C.T.L. provides for a specific anti-abuse clause aimed, in particular, at Type 2 entities (*i.e.*, low taxed foundations and offshore companies). The provision allows the Belgian tax administration to disregard transactions made by these entities when subject to pass-thru taxation.[12] This regulation is not applicable to trusts.

Parliamentary documents clearly state that the general anti-abuse clause of Article 344-§1 B.I.T.C., which applies to income taxes, remains in place and can also be of use in cases where the taxpayer "makes an appeal on several multi-layered legal structures with a view to escaping the scope of the Cayman Tax." These very broad anti-abuse provisions give the tax administration a wide range of action and may be subject to challenges from taxpayers.

C.T.L. legislation also contains a specific anti-abuse clause, which states that, as of October 9, 2014, modifications to the deed of settlement of a trust with a view to restructuring a Type 1 entity into a Type 2 entity, or vice versa, cannot be upheld against the tax administration. The parliamentary documents clarify however that restructuring an "in scope entity" into an "out of scope entity" cannot be targeted by this specific anti-abuse provision. Nonetheless, it should be borne in mind that in such a case the general anti-abuse clause of Article 344-§1 B.I.T.C. may be applied.

Ruling Request

The parliamentary documents provide that the Belgian (Federal) Ruling Commission is competent to grant advance clearance on the application of the C.T.L. Given the many uncertainties in the application of the C.T.L., seeking advanced clearance may often be the only way to achieve legal certainty for Founders or Third-Party

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[11] This new anti-abuse clause is not to be confused with Article 344-§1 B.I.T.C., which contains the general anti-abuse rule as it applies to Belgian income taxes. This rule allows the Belgian tax administration to "restore" the taxable base and tax computation to achieve taxation in accordance with Parliament's objectives, as if the alleged abuse had not taken place. In order to apply this anti-abuse rule, the tax administration must provide (complex) proof of "tax abuse," based on objective circumstances. In principle, tax abuse exists when the taxpayer realizes, through a legal act or a set of legal acts, a transaction that meets either of the following criteria:

- Contrary to the law's objectives, the transaction results in the taxpayer being excluded from the scope of the Tax Code or an executing decree's application.
- The essential goal of the transaction is to obtain a tax benefit, provided under the Tax Code or an executing decree, which if granted would be contrary to the law's objectives.

The taxpayer can avoid the anti-abuse provision's application by demonstrating that the legal act(s) is justified by (sufficient) motives other than tax avoidance.

[12] Article 344/1-§1 B.I.T.C.

Beneficiaries. Among the tax rulings issued by the Belgian Ruling Commission in November of 2016, at least five related to trusts.

Reporting Obligations for Founders and Third-Party Beneficiaries

The Belgian tax authorities are entitled to request that Founders or Third-Party Beneficiaries provide ample documentation on trusts. These reporting obligations have been further increased by the Law of December 26, 2015. Since the reporting obligations may have an impact on beneficiaries, trustees must also pay close attention to the requirements, which include providing adequate and timely information as well as documentation about the trust assets and the trust income. Sometimes, it will be useful to provide written statements on a person's beneficial entitlement, or the denial thereof, thus safeguarding that person from adverse tax consequences.

Even though the C.T.L. is not targeting trustees *per se*, trustees must closely monitor the obligations applicable to Belgian-resident Founders and Third-Party Beneficiaries. C.T.L. provisions require that the existence of a trust be reported in the taxpayer's annual tax return, along with the income generated by the trust assets. More precisely, the following information must be reported:

- The full name of the entity
- The legal character of the entity
- The address of the entity
- The name and address of the trustee

To the extent a trust has received income that is subject to pass-thru taxation, the Belgian taxpayer is required to report the income on his or her income tax return. However, as a practical matter, taxpayers do not always have full access to the necessary information in order to comply with these reporting requirements. Trustees should bare this obligation in mind when requested to provide information that would enable the Belgian taxpayer to file a correct income tax return. Noncompliance by a Belgian-resident Founder or Third-Party Beneficiary results in a fine of €6,250 per legal construction per tax year. Hence, trustees should verify their legal position in relation to a fine imposed on a Founder or Third-Party Beneficiary in the event of undue failure of the trustee to provide the necessary information.

No Automatic Indication of Fraudulent Behavior

Finally, the parliamentary documents clearly specify that the mere existence and reporting of an entity within the scope of the C.T.L. cannot be seen as an indication that the Founder and/or Third-Party Beneficiary has committed a tax offence in the past, nor can the first declaration of taxable income under C.T.L. legislation be seen as such. However, the tax administration's full range of investigative possibilities will remain in place, *inter alia*, in relation to the source of the funds transferred to a trust.

CONCLUSION

The tax treatment of trusts under Belgian tax laws is extremely complex. Although the principles, as proclaimed by the Belgian tax authorities, of pass-thru income

taxation upon distribution may seem relatively straight forward, in practice there is a high level of uncertainty involved. Moreover, pass-thru treatment under C.T.L. regulations is not matched with the regulations that apply in relation to death duties. Therefore, when dealing with trusts in a Belgian tax environment, the utmost caution is advised.

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