TAXATION OF TRUSTS AND FOUNDATIONS IN THE NETHERLANDS

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INTRODUCTION

People cross borders. They move to other countries and they invest abroad. Crossing borders invariably raises the question of foreign tax exposure. Legal systems regarding taxation differ significantly between jurisdictions, and legal vehicles used to attain a specific goal often must be revised when a border is crossed.

A clear illustration of this is the trust, which is widely used in the Anglo-Saxon world, but not in continental Europe, where foundations are widely used. In the Netherlands, statutory law is not familiar with the trust as a legal form, even though trusts settled according to foreign law are respected under the Hague Convention on Trusts (July 1, 1985). Trusts are quite often associated with tax avoidance. For that reason, the Netherlands has implemented anti-abuse rules which can be relevant for persons living in the Netherlands or abroad.

In comparison, foundations are often used to perform the same functions as trusts. A Dutch foundation (known as a "*stichting*") has legal personality and holds assets and liabilities in its own name. However, a *stichting* is not permitted to distribute income to its founder, board members, or persons closely related to them. As a result, a *stichting* is generally not a suitable vehicle for separating assets from one's private estate.[1]

That said, in corporate structures, a *stichting* frequently is used to separate economic ownership from legal ownership of assets, particularly shares. The owner contributes assets to the *stichting*, which in return issues certificates representing the economic ownership of those assets. The certificate holder is entitled to all income, but the foundation retains and exercises the voting rights. The tax treatment of the certificates could differ depending on the nature of the assets that are linked to the certificates.

In a widely used structure, a *stichting* will hold 5% or more of the shares in a company in order to achieve a substantial participation. The *stichting* issues certificates. The certificates are treated in the same way as the underlying shares. They are also taxed as a substantial interest in the share capital of the underlying company.

A *stichting* is often used to acquire real estate, where the acquisition is partly funded by a bank loan and partly by the issuance of certificates. In this fact pattern, the certificates may be treated as a separate asset class having the form of a receivable and the certificates cannot be replaced by the underlying assets (the real estate) and the liabilities (the loan). However, the Dutch tax treatment may be different. A *stichting* that issues certificates can be used to hold investments, even though it is

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1 In comparison, applicable law in some European countries allow foundations to distribute income to the founders or directors or to both.

normally not regarded as an investment fund. Nonetheless, a foundation is included in many Dutch investment fund structures to hold the legal title to the investments on behalf of the investment fund.

This article focuses on the tax treatment of the discretionary trust under Dutch law and the tax regime introduced to address the use of separated private assets.

THE A.P.V. REGIME

Discretionary trusts are more or less treated as tax transparent entities. This transparency is achieved, because the assets, liabilities, and income of a trust are attributed to the contributor as if no contribution took place. This is commonly referred to as the attribution rule which is at the heart of the *Afgezonderd Particulier Vermogen* ("A.P.V.") regime.

An A.P.V. is defined as a segregated estate that is intended to serve a private interest that is more than incidental. The definition is broad and open-ended. It encompasses various foreign legal forms used to segregate assets and to take account of international and future societal developments. Examples of A.P.V.'s include a trust, a *stiftung*, an *anstalt*, or a *treuhand* serving a private interest.

The fund must be discretionary in nature. For example, the board may freely decide how the A.P.V.'s assets are to be distributed, so that no person has legally enforceable rights against the fund. An example is a wholly discretionary trust. The term "private interest" refers to a situation in which the assets primarily benefit a limited, closed group of individuals and where admission or replacement of members is not easily possible. Typically, this involves the family circle of the original contributor and includes spouses and children. The critical question is whether the A.P.V.'s actual activities are predominantly focused on private interests and whether the nature and scope of the contributed assets predominantly indicate a private purpose.

The A.P.V. regime does not apply (i) to an arrangement that serves a social purpose or (ii) when a formal segregation of ownership interests occurs. Examples of a formal segregation include the issuance of shares, profit shares, membership rights, certificates of participation, or comparable rights. The rationale for this exclusion is that the economic interest is already held by an identifiable person who can be taxed directly.

The initial contribution of assets to an A.P.V. does not constitute a taxable event for Dutch gift tax purposes. Any distribution made by the A.P.V. to a person other than the contributor while the contributor is alive is treated as a gift. Upon the death of the contributor, any person who receives an interest previously deemed owned by the contributor is treated as receiving an inheritance.

As mentioned above, a fund will not qualify as an A.P.V. if it serves a social purpose rather than a private interest. Case law illustrates the boundary between the two. A family foundation that makes payments primarily to family members, with some minor funding for medical research, serves no social interest because payments are made only to members of a single family. The fact that a family includes a large number of members is irrelevant. Maintaining family cohesion and managing the family burial plot are not considered to be social objectives.

A fund must serve a private interest to more than an incidental extent, which is understood to mean 10% to 15%. This threshold strikes a balance between (i) preventing tax avoidance in cases of genuine private or family-oriented asset segregation and (ii) ensuring that legitimate philanthropic initiatives focusing on the general public would not be discouraged.

ATTRIBUTION OF ASSETS

Attribution to the Grantor

As mentioned above, assets, liabilities, and income of a trust are attributed to its grantor. In principle, this applies only to individuals. The attribution rule is effectively equivalent to tax transparency. As a consequence, several traps commonly exist for the unwary:

- If a grantor of a trust moves to the Netherlands, he or she will be subject to income tax in the Netherlands with regard to the worldwide income received by the trust. In addition, the grantor of the trust is deemed to be the owner of the trust assets and the obligor under the trust's liabilities.
- A nonresident grantor can be subject to Dutch income tax with regard to Dutch source income of a foreign trust. Dutch source income includes among others income from real estate situated in the Netherlands and income from a substantial interest of a company situated in the Netherlands.[2]
- If the assets of the trust pass upon the death to an heir or legatee, a deemed transfer is viewed to have occurred. This deemed transfer could potentially trigger capital gains tax depending on the assets owned by the trust. For example, under the current Dutch tax regime capital gains tax may be due in connection with the deemed transfer of a substantial interest in shares held by the trust.

Attribution to Heirs

Upon the grantor's death, the assets of the A.P.V. are attributed to the heirs. The term "heir" is interpreted in accordance with statutory inheritance law or a will. The legislature deliberately chose the term "heir" rather than "beneficiary under the law of succession" because the latter also encompasses legatees and beneficiaries under specific bequests. Inclusion of those recipients could produce unreasonable results. Allocation among heirs follows the statutory or testamentary distribution. This approach is intended to create a robust system that is considerably more difficult to circumvent through tax planning structures.

The term "heir" includes a person who has been disinherited but who, by law or in fact, directly or indirectly, is a beneficiary of the segregated private assets. It also includes a person whose partner or lineal relative is a beneficiary. The term "disinheritance" is broadly interpreted and applies not only to explicit disinheritance but also to implicit disinheritance, such as the appointment of another person as heir under a will.

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[2] Again, an interest is substantial if it represents 5% of the issued and outstanding shares.

Just like the grantor, the heirs can become subject to Dutch income tax if they live in the Netherlands. And if the successor beneficiary lives outside the Netherlands, the successor beneficiary can be taxed in the Netherlands on income derived from Dutch source assets and gains from their disposition.

Attribution to Beneficiaries

If the contributor, his or her partner, and heirs cannot be identified, the assets are attributed to the beneficiaries. The term "beneficiary" encompasses anyone who is, in substance, a beneficiary by reason of the receipt of good title to an asset. The term also includes someone designated by the board at a later date.

The Attribution-Stop

The assets of the A.P.V. are not attributed to the grantor, heirs, or beneficiaries if the A.P.V. operates a business and the income generated by that business is subject to a tax on profits. This rule applies only to business assets. All non-business assets held by the A.P.V. remain subject to attribution. In practice, most trusts hold assets passively and will therefore not benefit from the attribution-stop.

DUTCH INCOME TAX CONSEQUENCES OF DISTRIBUTIONS

Because the assets and income of the A.P.V. are directly attributed to the grantor, heirs, or beneficiaries, a distribution by the A.P.V. to such persons has no additional income tax consequences.

If an A.P.V. makes a distribution to a person to whom the assets are not attributed, there are no income tax implications in the case of a discretionary trust, because the beneficiary has no source of income to which the distribution can be attributed. The position may differ if the A.P.V. is not entirely discretionary and the beneficiary holds legally enforceable rights.

DUTCH GIFT AND INHERITANCE TAX

The Netherlands levies inheritance and gift tax at rates of up to 20% (for the spouse and children) and 40% for others where the testator or donor is a tax resident of the Netherlands at the time of death or the date of the gift. Dutch law contains a rule under which Dutch nationals who have emigrated are deemed to be a resident of the Netherlands for an additional 10 years after leaving the Netherlands. The A.P.V. regime applies equally to Dutch gift and estate taxes, which means that if a grantor, heir, or beneficiary passes away, the assets and liabilities of the trust which are attributed to him or to her are deemed to be obtained by his heirs and subject to inheritance tax. The statutory provisions of the Inheritance Tax Act 1956, including the available exemptions and the business succession scheme, apply *mutatis mutandis*.

If an A.P.V. makes a distribution, it is deemed to have been made by the contributor, heirs, or beneficiaries to whom the assets are attributed. A practical problem arises where the assets are attributed to multiple persons, as a distribution is, in principle, attributed to those various persons, and it is not possible to attribute the distribution exclusively to a single person. One approach to address the issue is to attribute the assets and liabilities *pro rata* to the value of (i) the initial contribution or (ii) the interest in the deceased grantor's estate. If a person does not receive more than the amount which is already attributed to him or her, it would be logical that no Dutch gift tax should be due. However, the law is not clear in this respect. A risk exists that a portion of a lifetime gift must be attributed to all other persons to whom the assets of the trust are attributed. If that person lives in the Netherlands, gift tax will be due.

An example illustrates the working of the law. Assume that two brothers are the sole heirs of their father's estate. Father has granted €1.0 million to a trust. One brother resides in the U.S. and the other brother in the Netherlands. The trust distributes €100,000 to the brother in the U.S. The assets of the trust are attributed 50/50 to the brothers. Therefore, half of the gift could be attributed to the brother living in the Netherlands and would then be subject to gift tax. Of course, this is not logical as long as the brother living in the U.S. does not receive more than €500,000, representing the assets that were attributed to him in the first place. This is an important issue to look into when setting up a trust structure or when people involved in the trust move to the Netherlands.

An important advantage of the Dutch system is that the contribution of assets to an A.P.V. is not considered as a donation for Dutch gift tax purposes. This represents a fundamental departure from earlier case law, under which the Supreme Court ruled that a trust could be regarded as an acquirer for gift and inheritance tax purposes.

In practice, this exemption is a useful estate planning tool as it allows assets to be set aside without incurring gift tax, which can facilitate the use of an A.P.V. for non-tax reasons. The exemption also applies to subsequent contributions of assets. Note, however, that the exemption does not apply to the extent that the A.P.V. is not discretionary.

THE DISCRETIONARY VERSUS NON-DISCRETIONARY DISTINCTION

The attribution rules apply only to the extent that an A.P.V. is non-discretionary. For assets to be classified as non-discretionary, it is not sufficient that they must be used for persons designated as beneficiaries. That circumstance, alone, does not imply that one or more beneficiaries have a concrete, legally enforceable right to those assets. To the extent that beneficiaries have specific, legally enforceable rights, the assets are not attributed to them but to the A.P.V.

Remarkably, the law does not clearly specify how attribution is to be carried out if the A.P.V. is not entirely discretionary. The beneficiary, however, is taxed independently. The beneficiary has a claim that will, in principle, be taxed as an economic right (assets). Under certain circumstances, however, it may also have the character of a *usufruct* on shares constituting a substantial interest.

The legislative history sets out the following approach:

- The discretionary portion is attributed to the grantor or, after that person's death, to the heirs.
- The nondiscretionary portion is directly attributed to the person holding that right.

In the case of a fixed trust, the beneficiaries hold enforceable rights on a distribution. The grant of these rights is seen as a direct gift from the grantor to the beneficiary. That gift is subject to Dutch gift tax if the grantor is a tax resident of the Netherlands.

CONCLUSION

The Dutch A.P.V. regime represents a comprehensive and technically sophisticated framework for the taxation of trusts and foundations. At its core is the attribution rule, which treats the assets, liabilities, and income of a segregated private estate as if no separation ever took place, attributing them directly to the grantor for tax purposes. This approach effectively renders the discretionary trust fiscally transparent under Dutch law, removing any tax advantage from the mere act of placing assets into a trust or foundation structure.

The regime presents a number of practical challenges, particularly (i) when the beneficiaries of the trust are not the same as the heirs of the person to whom the assets of the trust are attributed (or the interest in the estate and possible distributions by the trust are not the same), (ii) when the assets are contributed by more than one grantor or are attributed to more than one heir, (iii) where the discretionary and non-discretionary elements of a trust overlap, or (iv) where a contributor or heir resides outside the Netherlands and is unfamiliar with the Dutch attribution rules. These rules become particularly relevant when a contributor or heir moves to the Netherlands.

Finally, each of the persons involved in a trust, such as the grantor, the trustee, the beneficiaries, and the protector should be aware of the obligation to disclose his or her affiliation with a trust on a timely basis in a Dutch income tax return.

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