

Tax Look through Provisions for Trusts and Foundations

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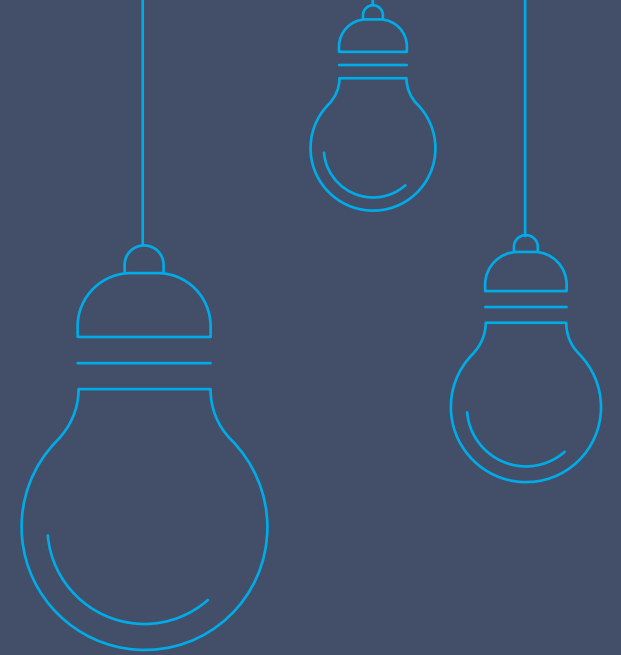
01 Scope



Scope

- In this panel, we will focus on trusts as express trusts and on private benefit foundations.
- Furthermore, the explanations refer to foundations and trusts that have been effectively established in accordance with the law of their country of domicile.
- For the purpose of this panel, we focus on the “STAK” when discussing the foundation in the Netherlands. Moreover, we focus on the “STAK” that holds more than 5% of the shares in a corporate entity (substantial interest).
- We do not cover the CFC rules for foundations and trusts.






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02 Tax Treatment of Trusts and Foundations - Overview

Tax Treatment of Trusts and Foundations

Overview

| |  |  |  |  |  |
|---------------------|--|--|--|---|---|
| domestic foundation | opaque | opaque | opaque (STAK) | foreign foundations and statutory foundations that are not classified for tax purposes as a trust (or another special classification) will be classified as a business entity , which depends on the purpose of the entity. Both trusts and business entities can be transparent or opaque | PBF not recognised in India |
| foreign foundation | transparent or opaque , depending on who has control over the use of the assets and distributions | transparent or opaque , depending in principle on who has economic control over the assets ("substance over form" approach) | in principle transparent for personal income tax , inheritance tax and gift tax if the trustee has discretionary power | | As per lex domicilii |
| trust | | | | transparent or opaque | Transparent or opaque |
| civil law | | | | common law | |

03 Tax Treatment of Domestic Foundations and Trusts

Tax Treatment of German Foundations under German Law

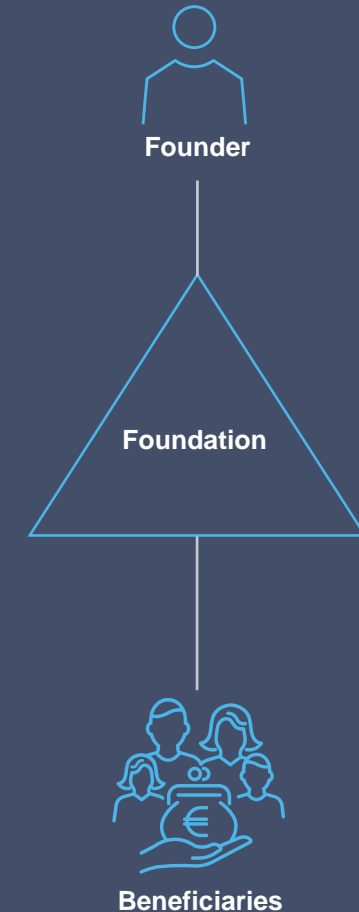
Opaque Foundation - Independent Tax Entity

Taxation of the Foundation

- Foundation itself is subject to corporate income tax on its current income
- Foundation is only subject to additional trade tax if it has a business operation
- Transfers of assets to the foundation are subject to inheritance tax or gift tax
- Substitute inheritance tax for family foundations - every 30 years, an inheritance is assumed on the assets of the foundation

Taxation of the Beneficiaries

- Statutory distributions by the foundation to its beneficiaries are subject to capital gains tax
- Non-statutory distributions by the foundation are subject to gift tax
- In the event of the dissolution of the foundation, the assets acquired by the beneficiaries are subject to gift tax and may also be subject to capital gains tax



Tax Treatment of Swiss Foundations under Swiss Law

Opaque Foundation - Independent Tax Entity

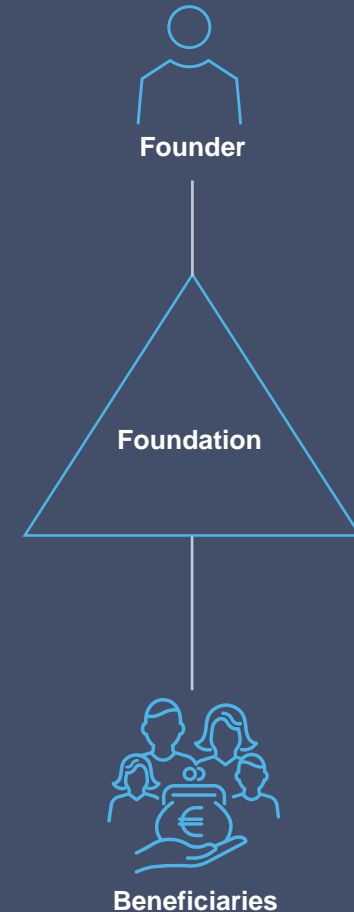
Note: The permitted purpose of so-called Swiss private family foundation is extremely limited (possible distributions to beneficiaries are very limited). Not frequently used in practice.

Taxation of the Foundation

- Foundation itself is subject to federal and cantonal corporate income tax on its current income
- In principle, foundation is also subject to cantonal capital tax on its net wealth (depending on the canton in which the foundation is resident)
- In principle, transfers of assets to the foundation are subject to inheritance tax or gift tax

Taxation of the Beneficiaries

- Distributions to beneficiaries are subject to income tax
- In case of dissolution, the transfer of assets to beneficiaries has, in principle, the same tax consequences as distributions



Tax Treatment of Dutch Foundations under Dutch Law

Note: Dutch foundations are generally not permitted to make distributions to the founder or the beneficiaries. For this reason, the so-called STAK (Stichting Administratiekantoor) is generally the preferred option.

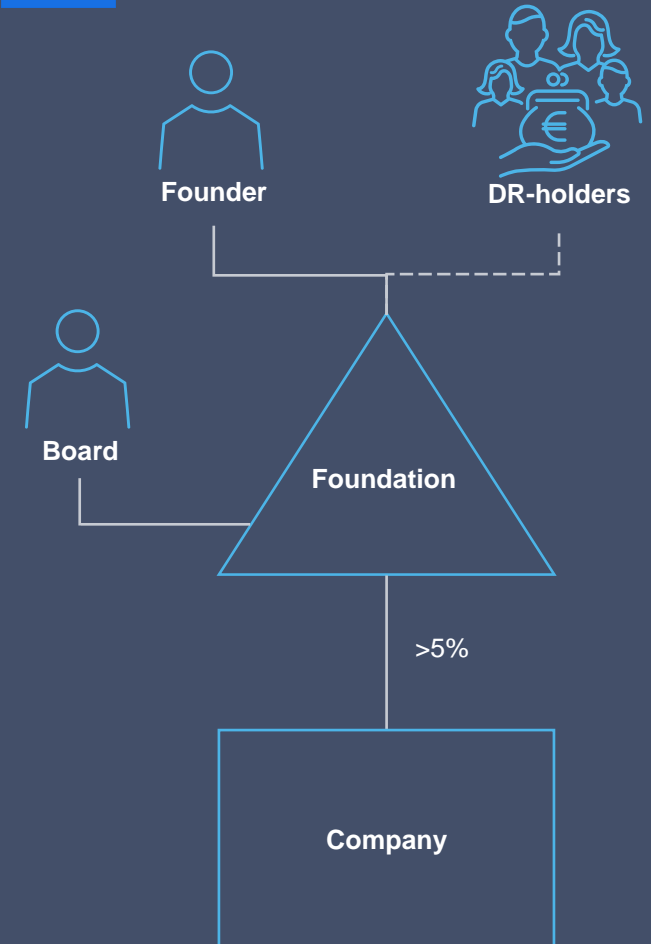
The STAK issues depositary receipts for the assets held. The STAK acts as an agent and is obliged to immediately pass on the benefits it receives from – for example – the shares held by the STAK to the respective depositary receipt holder.

Taxation of the Founder

- Founder is subject to personal income tax on the income derived from the depositary receipts if he/she is (deemed) Dutch resident or, if the founder resides in a foreign country, if he/she holds depositary receipts of more than 5% of the shares in a Dutch company
- Transfer of assets from founder to STAK is tax-neutral if certain requirements are met (Annex A)

Taxation of the Beneficiaries

- The STAK may only distribute income to the depositary receipt holder. In case the founder donates depositary receipts to the beneficiaries, this gift is subject to Dutch gift tax, if the donor is (deemed to be) resident in the Netherlands
- Upon death of the founder, the depositary receipts will be part of the founder's estate and as a result subject to Dutch inheritance tax, if the deceased founder is (deemed to be) resident in the Netherlands



Tax Treatment of U.S. Foundations under U.S. Law

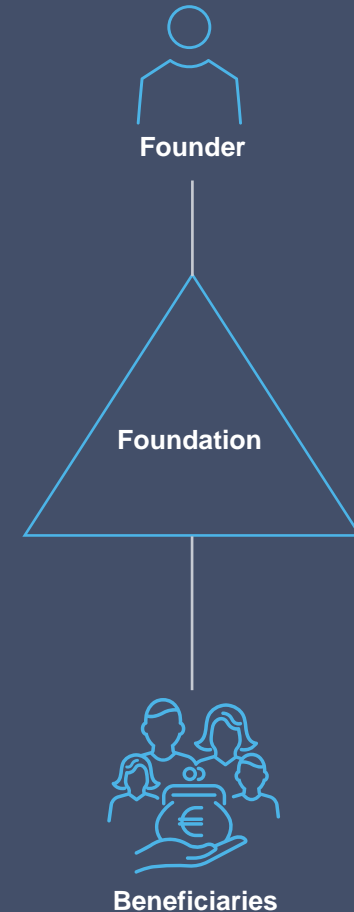
- In principle, U.S. common law does not provide a foundation that corresponds to foreign (private benefit) foundations.
- However, in two states (New Hampshire in 2017 and Wyoming in 2019) it is possible to set up a "statutory foundation" = independent legal entity established under the law of a U.S. state that can be treated for tax purposes as a business entity or a trust

Treated as **trust** for tax purposes

- Purpose is to protect or conserve property for its beneficiaries
- Beneficiaries (if it has them) are generally passive participants with limited rights (e.g., no transferability)
- Duties of the foundation's directors are similar to those of trustees, albeit with more limited liability
- Operation of business may not taint status if main purpose is to preserve assets and beneficiaries are passive

Treated as **business entity** (corporation or partnership) for tax purposes

- Purpose is enterprise for conduct of "business for profit" by "associates"
 - (1) "*business for profit*" = express terms in governing document to operate a business, divide the profit from it, have limited liability
 - (2) "*associates*" = persons who:
 - have an economic interest in the profits of the enterprise
 - voluntarily participate in the enterprise, can transfer interest



Tax Treatment of U.S. Trusts under U.S. Law

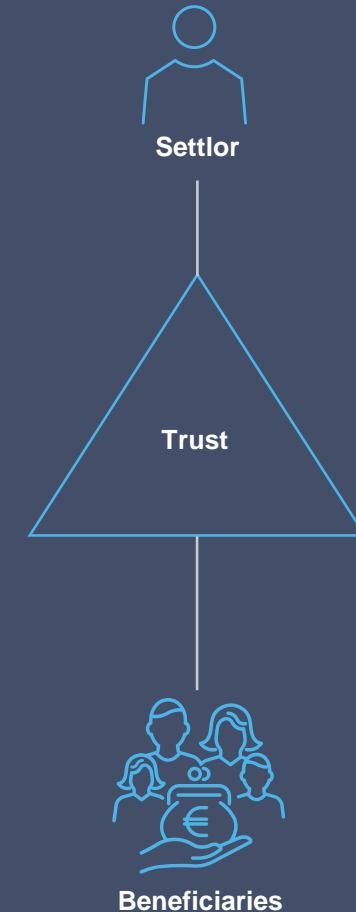
- For income tax purposes, a trust is “grantor” (transparent) or “non-grantor” (opaque)
- If a trust is a grantor trust, it is either “revocable” or “irrevocable”
- If a trust is a non-grantor trust, it is “irrevocable” only
- Revocable for testamentary planning; irrevocable for lifetime planning
- Non-grantor trusts always opaque (trust pays tax, or beneficiaries if trust distributes)
- Grantor trusts always transparent (settlor pays tax, in some cases beneficiary if owner)

Grantor Trust = Tax Attributed to Settlor (or Beneficiary)

- Domestic trusts can be grantor or non-grantor trusts, but presumption for foreign trusts is non-grantor
- Grantor trusts useful because allows trust to grow income tax-free
- Aside from income tax, grantor trusts can be either used for lifetime transfer tax planning (to move assets out of settlor’s estate, as an irrevocable trust) or testamentary planning (to avoid probate on death, as a revocable trust)

Non-Grantor Trust = Independent Tax Entity

- Trust is its own taxpayer and acts as pass-through only if distributions are made to beneficiaries
- In domestic context, non-grantor trusts less common than grantor trusts because trust tax rates more compressed than for individuals (37% >\$15.2k vs. 37% > \$609,350)
- Non-grantor trusts apply in lifetime transfer (or income) tax planning context and in testamentary context



Tax Treatment of Indian Trusts under Indian Law

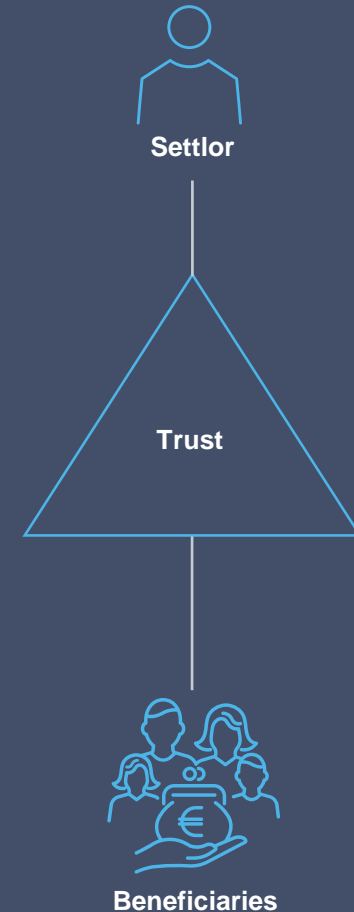
- 2 types of private benefit trusts recognised in India, Revocable and Irrevocable
- Revocable: where the Settlor has the power to revoke the trust assets
- Irrevocable: where the Settlor does not have the power to revoke the trust assets

Revocable Trust: Transparent

- Income earned by the Trust is taxed in the hands of the Settlor
- Settlement of assets into the Trust is tax neutral
- Distribution to beneficiaries taxable unless the beneficiaries qualify as 'relatives' of the Settlor

Irrevocable Trust: Opaque or Transparent

- Income earned by the trust is taxed in the hands of Trustee (in case of discretionary trust) and in the hands of either the trustee or the beneficiary
- Settlement of assets into an irrevocable trust is tax neutral (likely to change with the introduction of inheritance tax)
- Distribution to beneficiaries not further taxable



04 Tax Treatment of Foreign Foundations and Trusts

Tax Treatment of Foreign Foundations and Trusts

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Transparent or Opaque?



- the decisive factor for the classification of a **foreign foundation** or a **foreign trust** as transparent or opaque is who is deemed to be the **economic owner** of the assets
- criteria developed by case law and the tax authorities



- "substance over form" approach: the decisive factor for the classification of a **foreign foundation** or a **foreign trust** as transparent or opaque is who is deemed to have **economic control** over the assets (in addition, for trusts, the Settlor's place of residence upon establishment of the trust is also a decisive factor in itself)
- criteria developed in an administrative circular (Circular n° 20 of the Swiss Federal Tax Administration) - directly applicable to trusts and by analogy to foreign foundations
- practice of tax authorities may vary from one canton to the other - possibility to obtain an advance tax ruling (recommended)



- if an individual taxpayer transfers assets to a **foreign foundation** or **trust** without receiving economic entitlements in return, the foreign foundation or trust will be regarded as a "separate private estate" (SPE) and the *SPE-regime* applies
- SPE-regime: the transfer of assets is ignored, and the assets continue to be attributed to the founder/settlor (**transparency**), provided that the foreign foundation or trust qualifies as discretionary; the SPE-regime does not apply to fixed interests
- exception: for corporate income tax and real estate transfer tax a foreign foundation or trust is deemed to be **opaque**



- a **foreign foundation** is taxed either as a **trust** (presume non-grantor) or as a **business entity** (presume corporation unless elect)
- a **foreign trust** is presumed opaque as **non-grantor trust** unless qualify for exception as **grantor trust**

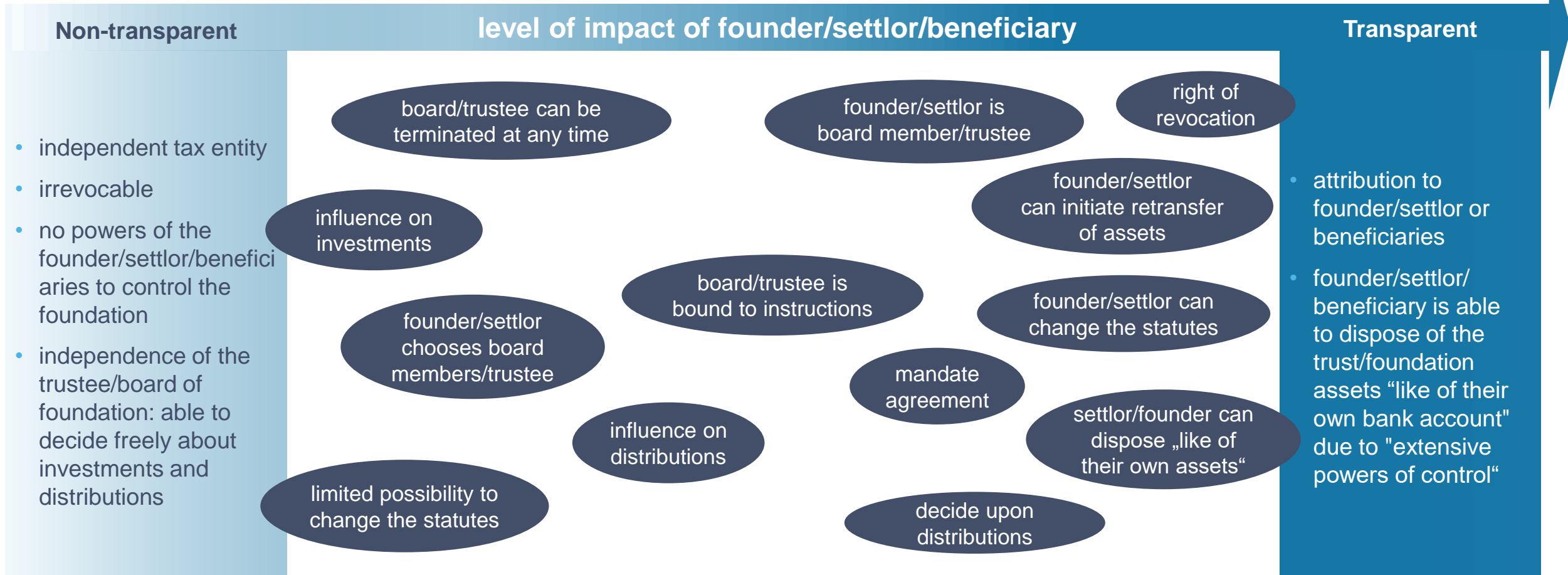


- **foreign foundation** to be taxed as per lex domicili
- **transparent or opaque** depending on who has control over the trust assets

Criteria for Classification in Germany

Transparent or Opaque?

attribution to economic owner - overall assessment of actual facts and circumstances



upon decease of the settlor/founder, the trust/foundation:

- becomes non-transparent, if transparency resulted from the fact that the settlor had reserved personal settlor rights
- remains transparent and is attributed to beneficiaries, if rights are transferred to beneficiaries



Same tax treatment of foreign foundations and trusts in Germany!

Non-Transparent

(independent Tax Entity)

- Entity liable for CIT on entity income (if place of management is in Germany)
- Establishment of and donations to entity = taxable gift from donor to entity (if donor is German-resident)
- Distributions to beneficiaries are subject to income tax; additional gift tax only for contributions contrary to the statute or in case of a fixed entitlement on distributions
- Dissolution of the entity: gift tax and in some cases additional income tax on the distributions to the beneficiaries

Transparent, attributed to **Settlor/Founder**

(strong impact of the Settlor/Founder)

- Settlor/founder personally liable for income tax on entity income
- Establishment / revocation of the entity = tax-neutral
- Distributions to beneficiaries = taxable gifts from settlor/founder to beneficiaries
- Transfer of power of influence to beneficiary upon settlor's/founder's decease leads to allocation of the assets to the beneficiaries - subject to inheritance tax

Transparent, attributed to **Beneficiary**

(strong impact of the Beneficiary)

- Beneficiary personally liable for income tax on entity income
- Establishment of and donations to entity = taxable gift from donor to beneficiary (if donor or beneficiary is German-resident)
- Distributions to beneficiary = tax-neutral
- Settlor's/founder's decease = tax-neutral



Similar tax treatment of foreign foundations and trusts in Switzerland. Tax treatment subject to advance tax ruling (highly recommended).

Non-Transparent

(independent Tax Entity)

- Foundation is liable for CIT on its income (if place of management is in Switzerland)
- Establishment of and donations to foundation = taxable gifts from founder/donor (if founder/donor is a Swiss resident; tax rate depending on canton of residence)
- Distributions to beneficiaries are, in principle, subject to income tax
- In case of dissolution of the foundation, the transfer of assets to beneficiaries is, in principle, subject to income tax

Transparent, attributed to **Founder**

(strong control of the Founder)

- Founder personally liable for income tax and wealth tax on foundation income / equity capital
- Establishment, donations by founder, revocation of foundation and distributions or retransfers of assets to founder = tax-neutral
- Distributions to beneficiaries (other than founder) = taxable gifts from founder to beneficiary (if founder is a Swiss resident; tax rate depending on canton of residence)
- Founder's decease = inheritance tax (if Founder is Swiss resident upon his/her demise; tax rate depending on canton of residence)

Transparent, attributed to **Beneficiary**

(strong control of the Beneficiaries)

- Beneficiaries personally liable for income tax and wealth tax on foundation income / equity capital
- Establishment of foundation = taxable gift from founder to beneficiaries (if founder is a Swiss resident ; tax rate depending on canton of residence)
- Donations to foundation = taxable gift from donor to beneficiaries (tax rate depending on canton of residence of donor)
- Distributions to beneficiaries = tax-neutral
- Founder's decease = tax-neutral

Note: Taxation is not regulated by law. According to the circular n°20 of the Swiss Tax Administration, a basic distinction is made between three types of trusts (irrespective of the nature/qualification of the trust under trust law):

Revocable Trust :

Strong economic control by settlor/beneficiary, for example :

- settlor is also a beneficiary
- right to designate beneficiaries
- right of revocation
- right of changing trust deed
- choose/terminate trustee/protector

Irrevocable Fixed Interest Trust:

- trust deed determines fixed amount and/or time of distributions, or
 - distributions' pattern appears to be "too" regular (economic approach)
- = fixed right on distributions

Irrevocable Discretionary Trust:

- trustee has discretionary powers regarding the distributions
- beneficiaries only have expectant rights
- no strong economic control of settlor/beneficiary

Transparent, attributed to Settlor/Beneficiary

- Settlor/beneficiary personally liable for income tax and wealth tax on trust income / equity capital
- Establishment, revocation of the trust and distributions or retransfers of assets to settlor = tax-neutral
- Distributions to beneficiaries (other than settlor) = taxable gifts from settlor to beneficiary (if settlor is a Swiss resident; tax rate depending on canton of residence)
- Settlor's decease = inheritance tax (if settlor is Swiss resident; tax rate depending of canton of residence)

Transparent, attributed to Beneficiary pro rata

- Assimilated to a usufruct right:
 - Beneficiaries personally liable for income tax and wealth tax on trust income / equity capital (pro rata)
- Establishment of the trust = taxable gift from settlor to beneficiaries (if settlor is a Swiss resident; tax rate depending on canton of residence)
- Distributions to beneficiaries = tax-neutral
- Settlor's decease = tax-neutral

Opaque, in principle (trust is not a taxpayer)

- Exception, attributed to settlor (transparent), if he/she is resident in Switzerland upon establishment of the trust
- Otherwise (pre-immigration trust), the trust is classified as opaque:
 - Establishment of and further contribution to trust = taxable gifts from settlor (if settlor is a Swiss resident; tax rate depending on canton of residence)
 - Distribution to beneficiaries (also in case of dissolution) are, in principle, subject to income tax, save for distribution of initial capital



Same tax treatment of foreign foundations and trusts in the Netherlands!

Regular case: *SPE-regime*

Transparent Entity, attributed to **Settlor/Founder**

- Settlor/founder is liable for personal income tax on assets of the entity income if he/she is (deemed) Dutch resident
- Transfer of assets from settlor/founder to entity is tax-neutral
- Distributions to beneficiaries (other than settlor/founder) result in taxable gifts if settlor/founder is (deemed) Dutch resident
- Upon death of the (deemed) Dutch resident settlor/founder, entity assets are attributed to his/her heirs in accordance with their entitlement to the estate and subject to inheritance tax
- If an heir is not a beneficiary of the SPE, nor can he/she become such a beneficiary, no attribution of the SPE's assets and income to the particular heir shall take place
- If someone is disinherited from the estate but a beneficiary of the SPE, the assets and income are attributed to him/her

Exception: *fixed interests & (deemed) enterprise*

Opaque Entity / Independent Tax Entity

- Foundation/trust itself is subject to corporate income tax if the foundation/trust is deemed to run an enterprise -> no transparency
- Foundation/trust itself is subject to real estate transfer tax -> no transparency
- Exception from the SPE-regime: in case a beneficiary has a fixed interest, he/she is subject to personal income tax on the fixed interest if he/she is (deemed) Dutch resident
- Please note that if the foundation/trust does not carry out an enterprise, the foundation/trust itself is not subject to tax, despite qualifying as opaque



Domestic if (1) U.S. court exercises “primary supervision” + (2) 1+ “U.S. persons” control “all substantial decisions”; otherwise foreign

Court test

- “Primary supervision” means U.S. court has authority to determine substantially all issues of *administration* of trust (another court can still have supervision)
- Safe harbor if (i) trust instrument does not direct foreign *administration* + (ii) trust *administered* in U.S. exclusively + (iii) no “automatic migration provision”
- “Administer” means maintaining books and records, filing tax returns, managing assets, defending suits by creditors, determining distributions
- “Automatic migration provision” means U.S. judicial attempt to assert jurisdiction over trust causes trust to migrate from U.S. (unless provision is only for foreign invasion, widespread confiscation or nationalization)

Control test

- “U.S. person” generally means U.S. citizen or resident income taxpayer, at least for individuals
- “Substantial decision” generally means all substantive (versus ministerial) trust decisions, except investment decisions if U.S. person can fire investment advisor at will
- Substantive decisions include distributions, amount thereof, who gets a distribution, allocation of receipts, termination, sue or defend suit, remove and replace trustees, designation successors
- Must consider all persons with authority to make trust decisions, not just fiduciaries
- Also consider power by vote and by veto

Income tax ramifications

- Foreign trust taxed as if nonresident alien (and thus generally taxable on U.S. source income, not necessarily capital gains), unless exception to tax as grantor (generally revocable) trust
- “Throwback tax” for “accumulation distribution” to U.S. beneficiaries (tax at ordinary rates and levy interest)
- Pre-immigration planning: NRA funds foreign trust with U.S. beneficiary within 5 years of becoming U.S. resident deemed to be owner of trust for U.S. tax purposes as of residency
- Outbound planning: U.S. person funding foreign trust generally a recognition event, similar if domestic trust becomes foreign while person living, unless exception applies



Note: Foreign Foundations to be taxed as per the law of domicile. Foreign Trusts to be transparent or opaque depending upon who has control. Same as treatment of Domestic trusts covered in slide 13.

Foreign Foundations / Trusts may be taxable in India in the following scenarios (connecting factors).

- **Foreign Foundation:** If the income arises from India (source taxation)
- **Foreign Revocable Trust:** If the Settlor is an Indian tax resident (worldwide tax (eligible for foreign tax credit)) or income arises from India (source taxation)
- **Foreign Irrevocable Trust:** If all the trustees and / or all the beneficiaries are Indian tax residents (worldwide tax (eligible for foreign tax credit) or income arises from India (source taxation).

Requirements for a tax neutral transfer of shares to a STAK

The following must be included in the articles of association of the foundation and the administration conditions:

- For each share transferred to the STAK, the STAK must issue a depositary receipt or a number of depositary receipts up to the same total nominal value of the shares transferred.
- The STAK may not dispose of or pledge the shares, although the STAK may dispose of a share if the proceeds are immediately transferred to the depositary receipt holder in exchange for surrendering the depositary receipt to the STAK.
- Dividends and other income received from the shareholding by the STAK must immediately be made available for the depositary receipt holder.
- Upon an issue of bonus shares or stock dividend on the share interest held by the STAK, the STAK issues new depositary receipts accordingly.
- If pre-emptive rights are granted upon the issuance of new shares, the STAK shall enable the depositary receipt holder to exercise a pre-emptive right to depositary receipts accordingly. The STAK shall exercise the pre-emptive right to the same extent as the depositary receipt exercise the pre-emptive rights granted to them accordingly.
- A liquidation payment received by the STAK is immediately transferred to the depositary receipt holder in exchange for the surrender of the depositary receipts.
- The power of alienation with respect to the depositary receipts may not be less than the power of alienation with respect to the underlying shares.
- The depositary receipts can only be revoked or returned after surrender of the corresponding share(s) to the depositary receipt holder.