

TRUST QUARTERLY REVIEW

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FRENCH TRAPS

TIPS FOR TRUSTEES AROUND THE WORLD WHEN DEALING WITH FRENCH ASSETS OR BENEFICIARIES

BY SOPHIE BORENSTEIN

The first French modified *Finance Law 2011* n°2011-900, which was published on 29 July 2011 and came into force on 31 July 2011, has enacted a specific tax regime applicable to trusts. A tax ruling from the French tax administration dated 23 December 2011, a decree dated 14 September 2012 and three tax guidelines from the French tax administration dated 16 October 2012 have supplemented this law.

First, a definition of a trust (a definition that will apply to all provisions of the French tax code) and of the settlor (a definition applying only to the provisions relating to the wealth tax and the registration duties) has been provided.

The trust is then defined as all the relationships created in a country other than France by a person (the settlor) by an *inter vivos* deed or by a will at death to put goods or rights under the control of a trustee in the interest of one or several beneficiaries, or for the realisation of a precise purpose.

The settlor of the trust is defined as the individual that set up the trust or as, when the trust has been set up by an individual acting as a professional or by company, the individual that has put in the trust goods or rights. Following the death of the initial settlor, all beneficiaries are considered as the settlor (deemed tax settlor).

A beneficiary of a trust is defined as anyone who is the income beneficiary or the principal beneficiary during the trust's life or at the time of its termination. In case of a trust *inter vivos*, the settlor can also be a beneficiary.

The French rules apply to all trusts:

- that contain French-situated property, even if the settlor, deemed tax settlor or beneficiary is not a French tax resident
- when any one of the settlor, deemed tax settlor or beneficiary is a French tax resident.

The French rules provide for a liability to inheritance tax and gift tax for all transfers made through a trust.

The transfer of assets to a trust is not subject to gift tax or inheritance tax. Taxation occurs at the time of the distribution of the trust's assets to the beneficiaries or, if earlier, on the death of the settlor.

Trustees are responsible for the payment of the taxes when:

- the goods, rights or revenues put in the trust are globally transferred to the settlor's descendants (a tax rate of 45 per cent applies); and
- there is no transfer and the assets remain in the trust, when the trustee is subject to the law of a non-cooperative state or territory (within the meaning of Art 238-0 A of the *French Tax Code*), in the case of transfer of a non-determined part to beneficiaries that are not the settlor's descendants, or where the trust was created after 11 May 2011 and the settlor was a French tax resident (a tax rate of 60 per cent applies).

The beneficiaries, either French tax residents or non-French tax residents, are jointly and severally responsible for the inheritance and gift tax payment where either (a) the trustee is liable for the payment of the taxes (i.e. only when the rates of 45 per cent and 60 per cent apply), or (b) the trustee is subject to the law of a non-cooperative state or territory (within the meaning of Art 238-0 A of the *French Tax Code*) or of a state with which France has not concluded a convention on mutual assistance in the collection of taxes.

In addition, the French rules provide that assets held in any kind of trust, irrespective of whether the trust is irrevocable or revocable, discretionary or not, are taxable on the settlor or on the deemed tax settlor, for French wealth tax purposes, either if the settlor or deemed tax settlor is a French tax resident or if the trust holds taxable French assets. For individuals who are liable to the French wealth tax, when they have not been French tax residents for the past five calendar years preceding the year during which they became French tax residents, they are liable to the wealth tax only on the French-located assets until 31 December of the fifth year following the year during which they became French tax residents.

However, this provision does not apply to trusts created for managing the pension rights acquired by the beneficiaries of the trust in connection with their professional activity within the scope of a pension scheme constituted by a company or a group of companies, or to charitable trusts when the trust's

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beneficiaries are exclusively charitable institutions fulfilling certain conditions.

The tax treaties concluded by France apply to both the French wealth tax and the French inheritance and gift tax.

Where the trust assets are not included in the estate of the settlor or the deemed tax settlor(s) for wealth tax purposes, or if the trust has not been disclosed to French tax authorities by the trustee (when the settlor or the deemed tax settlor is not liable to wealth tax), a specific tax of 0.5 per cent based on the market value of the trust assets as of 1 January is due. This 0.5 per cent levy is due:

- on all trust assets, rights or capitalised income located in France and abroad for settlors or deemed tax settlors who are French tax residents; but
- only on assets and rights located in France for settlors or deemed tax settlors who are not French tax residents.

This special levy is payable on a yearly basis by the trustee, but the settlor or the deemed tax settlor(s) are jointly liable as they are legally liable.

However, this levy of 0.5 per cent is not due in cases of:

- an irrevocable trust established for charitable purposes (i.e. when the beneficiaries are those of Art 795 of the *French Tax Code*, as mentioned above) when the administrator of the trust is subject to the law of a state or territory that has concluded a convention on administrative assistance in cases of fraud and tax evasion with France; or
- trusts created for managing the pension rights acquired by the beneficiaries of the trust in connection with their professional activity within the scope of a pension scheme constituted by a company or a group of companies.

For both the wealth tax and the 0.5 per cent levy, the trust's assets will be considered as split equally between the deemed tax settlors when there is no express distribution of the trust's assets either in the trust deed or in its additional ancillary agreements.

The taxable basis for the wealth tax and for the 0.5 per cent levy excludes the financial investments mentioned by Art 885 L of the *French Tax Code*. Financial investments are notably French bonds, deposits, French equity, shareholders' current

accounts, life insurance contracts, etc, held through French financial establishments or French companies.

Besides, the French rules provide that, where the settlor, the deemed tax settlor(s) or at least one of the beneficiaries is a French tax resident or where the trust includes an asset or right located in France, the administrator of a trust has to comply with these two independent, mandatory reporting obligations:

- A one-off disclosure of information on the creation, modification or termination of the trust (if that has occurred after 31 July 2011), as well as the content of its terms (i.e. the trust deed, but also the possible other additional provisions regulating the trust operation).
- An annual disclosure of the market value of the assets, rights or income capitalised or held in the trust on 1 January of each year.

The reporting obligations apply to trusts in existence, created, amended or terminated after 31 July 2011, and are not just based on situations as at 1 January 2012.

Non-compliance with these filing obligations is sanctioned by a fine of the higher of EUR10,000 or 5 per cent of the value of the assets, rights or products capitalised or held in the trust.

The financial investments mentioned by the Art 885 L of the *French Tax Code* (see above) are excluded from the annual disclosure obligation.

Thus, trustees must be prepared for:

- The annual declaration to be made before 15 June each year (exceptionally postponed to 30 September 2012 for this year) or 31 August each year (also postponed to 30 September 2012 for this year) when the settlor or the deemed tax settlor(s) are not French tax residents. Where applicable, the trust charge levy, currently set at 0.5 per cent, must be paid along with the declaration. It is strongly recommended to make a separate payment per trust as soon as each payment must be sent, along with the related declaration.
- The one-off declaration to be made within a month of any constitution modification or extinction of a trust should be declared (for 2012, the deadline is 31 December 2012).

The specific requirements for the application of these reporting obligations have been provided by a decree published on 15 September 2012 (Decree 2012-1050, dated 14 September 2012).

The two declarations have to be sent to the *Direction des résidents de l'étranger* (DRESG), 10 rue du Centre, 93465 Noisy-le-Grand Cedex, France.

The term 'modification of the trust' includes any changes to the terms or the operation of the trust, settlor, deemed tax settlor, beneficiary, trustee, any death of any of the above parties, any new settlement of assets or any distribution of rights, products or assets out of the trust, any transfer or attribution of assets, rights or products of the trust, and, more generally, any legal or factual modification that is likely to affect the economy or running of the trust.

Even if the decree provides that the declarations must be drawn up on plain paper, the French tax administration has issued two forms that can be used if needed (Form 2181 TRUST1 for the one-off disclosure and form 2181 TRUST2 for the annual one).

The decree also provides that the relevant tax residence (of the settlor or beneficiaries) is that of 1 January each year.

For both declarations, the following information is required:

I. Identity of the trust's parties

- Settlor(s) or deemed tax settlor(s):
 - Name and first name or corporate names
 - Address
 - Date and place of birth and, if applicable, date of death
- Beneficiary or beneficiaries:
 - Name and first name or corporate names
 - Address
 - Date and place of birth and, if applicable, date of death
- Trustee:
 - Name and first name or corporate names
 - Address

II. Identification of the trust itself

- Name
- Address

III. Details of the terms of the trust

Details of the contents of the trust deed and any additional terms or deeds in relation to variation or alterations to the running of the trust, in particular the indication of whether the trust is revocable or irrevocable, discretionary or not, and the rules applicable to attribution of the assets and rights settled into trust, as well as their products. However, for the annual declaration, the trustee does not have to indicate the content of the trust's terms if the one-off declaration was previously filed.

Regarding the one-off declaration, trustees will also have to mention the event justifying the reporting obligation, along with the details of the consistency of the assets at the date of the event, of the settlor and of the beneficiary or beneficiaries, with the following information:

- nature and date of the event that has triggered the reporting obligation
- consistency, at the date of the event, of the assets or rights put into trust as well as the nature and value of assets, rights or products distributed, granted or taken out of the trust as a result of this event
- for each asset or right put into trust: name and first name or corporate names, address and, if applicable, date and place of birth, and, if necessary, date of death of the individuals who are settling these assets; and
- for each asset, right or product distributed, granted or taken out of the trust: name and first name or corporate names, address and, if applicable, date and place of birth, and, if necessary, date of death of the individuals for which the asset, right or product has been distributed, granted or taken out of the trust.

Regarding the annual declaration, trustees will also have to mention the details of the assets, rights and capitalised products. Where at least one settlor, deemed tax settlor or beneficiary has tax residence in France, trustees should provide the French Tax Administration with a full inventory of the assets, rights, and capitalised products situated in France and outside France and held in trust, with the indication, for each of them, of their market value as at 1 January each year. Where none of the

settlor, deemed tax settlor or beneficiaries have tax residence in France, trustees should provide the French Tax Administration with a full inventory of the assets, rights and capitalised products situated in France only (except financial investments, as mentioned above) and held in trust, with the indication, for each of them, of their market value as at 1 January each year.

The traps to be avoided by trustees would be:

- Not paying the inheritance or gift tax when due.
- Not making the necessary disclosures before the due date, as huge penalties could be due. Indeed, after many years of non-disclosure by a trustee, the annual 5 per cent penalty could amount, at the end, to 100 per cent of the trust's assets.
- Not paying, along with the annual declaration, the 0.5 per cent levy when it is due.
- Not checking the legislation applicable to them as trustees, to the settlor and to the beneficiaries in their respective countries in view of their obligations of compliance, notably to avoid any potential conflicts with local law if the trustee resides in a jurisdiction that forbids such disclosure. For example, under Singaporean law the disclosure of information in relation to trusts to a foreign authority requires the consent of the settlor or beneficiaries.

The actions that could be recommended for trustees would be to carry out a complete and careful analysis of the trust's situation, by looking at the location of the assets placed into the trusts, at the nature of the assets placed into the trust, at the location of the tax residence of the trust's settlor and beneficiaries, and at the law governing the trust (application or not of a tax treaty with France).

Trustees should also identify the settlor and beneficiaries that could be affected, in particular in the case of discretionary trusts where there is a large range of beneficiaries for which French law, at that time, does not make any distinction (including beneficiaries who may never receive a distribution).

Trustees should also determine where the settlor and, more specifically, all the beneficiaries live (where there are no assets in France), which can be difficult when people are moving regularly (as students, businesspeople, retired people, etc). Indeed, even when just one person has moved to France, the disclosure obligation applies. Thus, trustees could be advised to inform the settlor, deemed tax settlor(s) and beneficiaries of the implications should they become French tax residents.

In addition, where the initial settlor is deceased, the trustee should inform the beneficiaries of their new position as deemed tax settlor.

The trustee should also inform, by letter, all settlors and beneficiaries that could be concerned by the law.

Regarding the 0.5 per cent levy, to determine their own liability, the trustee should check first with the settlor and the beneficiaries if they have made and filed appropriate and timely tax returns by including, in their estate liable to the French wealth tax, the trust's assets, rights and capitalised income.

It could also be appropriate for trustees, even if they have not already done it, to relocate the trust's French assets into a separate sub-trust if the settlor or any beneficiary is or could become a French tax resident, to avoid the disclosure of assets applying to non-French-located assets.

Trustees should also consider modifying the governing law of the trust when the current applicable law is either the one of a country that has not concluded a tax treaty with France or the one of a country that forbids any disclosure by the trustee, or requires the consent of the settlor or beneficiaries.

Trustees could also have an interest in releasing any existing French securities or mortgages in relation to a current loan (and not to take any in the future).



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