



## Trusts vs Taxation



### ***Taxation of the assets or the rights of a trust to wealth tax and transfer taxes where there is no consideration***

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***First overview of draft legislation MAY 2011***

**The article 8 of the finance bill rectified of 2011** aims at confirming and at covering the taxation of trusts and legal comparable foreign legal entities for transfer taxes where there is no consideration and wealth tax.

Thanks to the procedure of regularization of year 2009, the French administration was able to have a perfect knowledge of the schemes made a certain numbers of French residents to try to avoid taxes. They used this experience to prepare dissuasive texts.

**Considering the particularity of foreign law which utilise the trust, the tax regimes are sometimes hard to understand.**

Certainly, the case law recognizes the validity of trusts established abroad, but one is not always able to reconcile the comparative law of the trust with internal French law enabling to apply taxation within the French system.

This situation is a source of legal insecurity for the people that establish a trust and / or who are beneficiaries especially for those settling in France and who used a trust to organize the management or transmission of their estate.

The lack of clarity concerning the taxation of trusts can facilitate tax evasion. This results in an unbalanced treatment of taxpayers depending on how they are structured.

This project which is likely to be approved puts into question how one treats trusts historically that are already constituted prior to the law being passed, for tax resident of France whether correctly or incorrectly established.

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The draft law suggests strengthening the taxation of trusts both at the level of the free transfers and the annual ownership:

## **Fiscal definition of the trust**

The bill defines a trust in the following way:

"The law interprets a trust as all created legal structures, in the law of a State other than France, by a person, which has the quality of an establishment, by act between living or on demise, to invest assets or rights, under the control of an administrator (director), in interest of one or of several beneficiaries or for the realization of a definite objective."

"The law interprets by constituting the trust, either by an individual or a moral person, the person settling the assets or the rights assigned."

The notions of revocable, irrevocable, discretionary trust because of demise between living and others are not mentioned in the project.

**This text legalizes the definition which had been given within the framework of the tax of 3 %.**

### **BO-7-Q -1-08 §17**

The "trust" is a legal relation created by a person (the settlor) in the effect to place the assets under the control of a trustee, in interest of a beneficiary or for a particular purpose. A trust defines itself with regard to rights and duties exercised on assets by the trustee, the rights and duties which appear in the incorporation of the trust. "Members" of the trust settlor (s), trustee (s) and beneficiary (ies), including the allocated in capital are considered.

### **Concerning the definition of the trustee / administrator**

It is advisable to note draft legislation does distinguish the trustee which is appointed as an administrator (director) while traditionally they were considered as the visible owner. This definition also has the effect of reponsabilising the trustee administrator (director) among which their obligations and responsibilities were widely established and which are going to have more civil liabilities within the framework of the new exchange of information agreements. In fact the project covers the terms of the 'Tribunal de Grande Instance' (TGI) of Nanterre of May 4th, 2004.

## **Taxation of income resulting from a trust**

The project of law specifies that income resulting from a trust is likened to foreign income according to the article 120 of the Internal Revenue Code ; and no matter the composition of the assets or the rights placed in the trust that the income is taxable even though it may benefit from a low tax jurisdiction.

## **Taxation of free transfers**

The project specifies the tax regime of free transfers by way of a trust, on one hand confirms the present applicable rules of taxation, on the other hand creates rules of taxation for certain specific situations.

So, the bill:

1/ confirms that the free transfers realized via a trust and which can be qualified as donation or succession are subjected to the existing transfer taxes (as the case may be: rights of donation or succession) considering the family ties existing between the settlor and the beneficiary. This rules of taxation apply to the assets and rights in the trust and passed on by donation or succession. The assumption of ownership in the article 752 of the general tax code is expanded to take into account assets held in a trust.

2/ creates a rule of taxation in inheritance duties due to the death of the settlor.

When the qualification of donation or succession cannot be accepted and when consequently transfer taxes cannot be applied according to the rules of common law, specific inheritance taxes will now be applied, when the assets or rights are passed on demise or in a later date.

At the date of the demise, the rights of a beneficiary is determined, they will be taxed on death duties according their family ties with the dead settlor.

In case the rights belonging to the beneficiaries cannot be determined for each of them at the date of the death, transfer taxes for free transfers will be due at the death of the settlor, to the applicable maximum rate directly on the part of the assets or rights and which has authority to be passed on to descendants of the settlor and rate of 60 % is due on the other assets or rights remaining in the trust.

**In this case, inheritance taxes will be settled by the trustee.**

In application of the article 750 ter of the CGI, these taxes would be owed either when the deceased has their tax domicile in France according to article 4 B, or when the assets put in trust are situated in France.

Afterward, if the assets and the rights stay in the trust to generation to generation, the taxation is operated according to the same modalities between the successive beneficiaries.

## **Particular taxation concerning anti tax evasion**

Finally, in the particular case of trusts established in accordance with not cooperative territories or when the settlor was domiciled in France during the constitution of the trust, the rate applicable to the donations and in conjunction with inheritance taxes would be a unique rate of 60 %.

## **Wealth tax**

The law plans that "the assets or rights placed in a trust are included, for their clear market value on January 1st of the year of taxation, as the case may be, in the assets declared for ISF of the settlor or that of the beneficiary which is considered as being a settlor". (Art. 885 G revised).

## **Creation of an annual obligation on trusts**

The bill aims at creating an annual new tax on all assets and rights of the trust.

### **Taxable persons**

The physical persons, settlors and beneficiaries, of a trust are subjected to an annual tax.

### **The tax is due as follows:**

For the people that have in France their tax domicile per article 4 B, whereby they have assets and rights situated in France or outside France that are placed in the trust.

For other people, on the basis of only assets and rights, others than the financial investments exempted from the ISF, situated in France in the trust.

**Exception**

The tax does not apply to trusts established to manage pensions in conforming with a professional activity, by the beneficiaries within the framework of a pension plan put in place by a company or a group of companies.

**The basis of taxation**

The taxation is based on the market value on January 1st of the year of taxation of the assets and the rights within the trust.

**The Rate**

This tax would be due, at the maximum rate planned for the ISF which is 0.50 % in 2012.

**Statement of payment**

Declaration of existence

The administrator of a trust among which the settlor or one at least of the beneficiaries has their tax domicile in France, or which includes the assets or rights which are situated there, is held to declare the settlor, any modification or the termination, as well as the contents of their terms and conditions.

**Annual declaration**

The consistency and the valuation of the assets and rights in the trust are declared and the withholding tax is paid to the competent tax office by the trust at the latest on June 15th of every year.

In default, the settlor and the beneficiaries, or their heirs, are jointly responsible for the payment of the tax.

They also declare the market value on January 1st of the year of the assets and rights in accordance with the withholding tax du under article 990 J.

**Exception in the taking**

This tax is not applicable for assets and rights in the trust which

- Were included in the declaration of the settlor or the beneficiary for ISF, when the constituent or the beneficiary is liable for the ISF already,

Or

- Were regularly declared, when the constituent or the beneficiary were not liable to the ISF, including but the assets and rights and concerned capitalized were included in ones assets statement.

It is specified that, in that case, the settlor of the trust benefits from preferential treatments with regard to ISF, in particular as for the new residents of France who were not domiciled in France during five years preceding their installation. These people are taxable only on assets situated in France during the first five years of their installation in France.

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