CONTENTS

03 FOREWORD
THE EDITORS

05 TRUSTS IN SCOTLAND v
ENGLAND AND WALES
FIONA CLARKE

11 TRUSTS IN ISRAEL
DR ALON KAPLAN
AND MEYTAL LIBERMAN

19 RECOGNITION OF
TRUSTS IN ITALY
PAOLO LUDOVICI

25 TRUST-LIKE STRUCTURES
RICHARD FRIMSTON AND
PAOLO PANICO

31 UAE FOUNDATIONS
ISMAEL HAJJAR, MIDYA OMAR
AND SUZANNE REISMAN

37 BOOK REVIEW
TRISTRAM AND COOTE’S PROBATE
PRACTICE, 31ST EDITION, MAIN
WORK AND SECOND SUPPLEMENT,
EDITED BY MASTER PAUL
TEVERSON, ROLAND DCOSTA
AND TERRY SYNAK
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It seems to be the season for royal watchers, with noble weddings and births. The *Trust Quarterly Review* is happy to join the bandwagon with its review of a case of ownership of London real estate by the Luxembourg royal family. While the fundamental issue is common (who gets property on a divorce), the legal issues surrounding the rules on divided Crown ownership raise interesting questions that may become more significant as the world moves forward with anti-money laundering rules. In particular, changes to the language in the EU’s Fifth Anti-Money Laundering Directive (5AMLD) from the Fourth Anti-Money Laundering Directive (4AMLD) might give rise to planning opportunities.

5AMLD will come into effect by early 2020 and will amend art.31 of 4AMLD to require EU Member States to ensure this article applies to ‘trusts and other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts’.

Given the different treatment given to trusts by jurisdictions around the world, 5AMLD goes on to require Member States to identify the characteristics where legal arrangements have a structure or functions ‘similar to trusts’ with regard to legal arrangements governed under their law.

Perhaps the most significant change is that the law of the place where the trust or other structure is administered, rather than the law of the jurisdiction where it was created, determines whether registration and disclosure of information is mandated. This could raise compliance opportunities where a structure is created in, for instance, a civil-law jurisdiction such as Luxembourg, but is administered in a common-law jurisdiction that does not recognise that structure. Are our conflict-of-laws rules up to the task of determining whether the structure has a ‘function similar to trusts’, and therefore requires registration and disclosure? Or has a loophole been inadvertently created?

Italy’s legal system does not provide rules regulating the settlement and existence of trusts. Nevertheless, trusts established and governed under foreign laws are legally recognised in Italy, provided they are in compliance with the *Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition*, and are subject to a specific body of tax legislation. From a practical perspective, the trust has become a useful instrument for many Italian high-net-worth...
individuals in dealing with their wealth planning. We present an article outlining the main legal and tax ramifications to trusts, their settlors and their beneficiaries, including the recognition of trusts for civil-law purposes and the treatment of trusts for income and inheritance tax purposes.

One island, two legal systems: we are pleased to present an explanation of the differences between Scots versus English and Welsh trust law. There are common misconceptions as to the operation of trusts in these two jurisdictions. The fundamental difference is the laws’ divergence on the concepts of equity; this is critical to English and Welsh trust law, but absent in Scottish, while other disparities surround limitations on perpetuities, accumulations and successive liferents (life tenancies). Where the two legal systems align, differences of scale are also apparent. English and Welsh law provides more extensive statutory powers to trustees, often resulting in greater flexibility; Scots-law trusts can be far more restrictive, and hold a greater dependency on the powers in the trust deed.

Two articles on developments in the Middle East also feature in this issue. First, we report on the introduction of new foundation laws in the UAE that encourage regional wealth preservation for both Muslim and non-Muslim investors. Under these new laws, foundations will generally be treated as local legal entities having their own legal framework based on the common law of England and Wales, and their own independent courts. Second, we offer an article on Israeli trusts, which explains several ways they can be created, focusing on the ‘endowment’ or hekdesh. With a history of two legal systems, Israel recognises several ‘trust-like’ structures created in other jurisdictions.

As always, we welcome all suggestions and comments from our readers. We hope you enjoy the issue as much as we did.

THE EDITORS
ONE ISLAND, TWO SYSTEMS

The divergence of trust law in Scotland v England and Wales

BY FIONA CLARKE

ABSTRACT

- The conceptual basis of trust law in England and Wales differs significantly from that of Scotland, leading to some common misconceptions as to the operation of trusts in the two jurisdictions. The fundamental difference is the laws’ divergence on the concepts of equity – critical to English trust law, but absent in Scottish – while other disparities surround limitations on perpetuities, accumulations and successive liferents (life tenancies).

- Where the two legal systems align, differences of scale are also apparent. English law provides more extensive statutory powers to trustees, often resulting in greater flexibility; Scots-law trusts can be far more restrictive, and hold a greater dependency on the extent of powers in the trust deed.

- The Scottish Law Commission has considered a number of amendments to Scottish trust law that would reduce the areas of difference between the two jurisdictions, while the Law Commission of England and Wales intends to hold a comprehensive review of English trust law.

The UK’s intertwining legal systems from Scotland, England and Wales, and Northern Ireland can often lead to misconceptions and misunderstandings, particularly for those less familiar with the jurisdictions. The law in Scotland has its foundations in Roman law, but has been subject to considerable influence from English common law throughout its history, resulting in what is today considered to be a ‘mixed’ legal system, drawing as it does on elements of both civil and common law. This is in contrast to the purely common-law system in England and Wales.

While there are areas of law that are largely applicable across the UK (company and employment law being obvious examples), the law on trusts as applicable in Scotland and that in England and Wales are quite distinct, and based on entirely separate legislative and common-law provisions. This article will outline the key differences between the two jurisdictions’ legal frameworks surrounding trusts.

CONCEPTUAL FOUNDATIONS

EQUITY

The conceptual foundation of trusts differs between Scotland and England and Wales, and the most fundamental difference is in the legal
concept of equity. Equity is fundamental to English law, but does not exist under any area of Scots law. The law of equity will be well known to any practitioners accustomed to English law, but is often less familiar to those practising in other jurisdictions, particularly those with legal systems based in civil law. Equity is a concept developed under the English legal system to deliver redress in situations where the common law has not produced a solution to deliver a fair result. The concept was first implemented with the creation of a new court in 1558, separate to the common law, established to deal with ‘matters of the King’s conscience’; this court became the Court of Chancery. (At this time, England and Scotland were separate countries, prior to the Acts of Union in 1707 creating the United Kingdom of Great Britain, therefore Scots law was not influenced by the evolution of English law in this area.)

In that court, the judges were to look beyond the inflexible rules of common law, with the aim of producing a decision that was fair. The law of equity evolved to be so key to the core of the English legal system that it came to prevail following The Earl of Oxford’s Case in Chancery in 1615, when it was determined that, where common law and equity conflicted, equity should prevail. That supremacy continues today.

The concept of equity was similarly key in the evolution of trusts under English law, as the common law of the time did not allow for the recognition of more than one interest in property, and resulted in a view that ownership was absolute. The principle of equity allowed for recognition that there could be more than one interest in the same property: in the case of a trust, that is the legal interest, held by the trustee, and the equitable interest, held by the beneficiary. The concept of equity is unique to common-law legal systems.

The principle of equity also extends into other areas of English law, such as the joint ownership of land, which gives rise to a trust under English law. This is not the case under Scots law, where ownership is singular and absolute.

Equity is absent from Scots law, and under Scots law separate rights of ownership cannot exist concurrently in the same property. Comparable concepts of ‘rights’ are used in matters of ownership of property and trusts. These govern the differing rights of parties to trusts (and other legal arrangements) and consist of ‘real rights’ and ‘personal rights’, a principle of civil law, as opposed to common law.

REAL RIGHTS

Broadly, real rights are absolute rights that a legal person has ‘against the world’ in respect of property. A person who owns property, for example, has a real right to that property: to enforce their right over that property should that right be challenged. The concept originates from the Roman law, which still forms much of the foundation of Scottish property law, although many of the principles have been altered and have evolved over time.

PERSONAL RIGHTS

By contrast, a personal right is a right that a legal person has against another legal person: a right to have the person fulfil an obligation. In a Scottish trust, the trustees are absolute owners of the trust property, and so have a real right to that property, and to hold and defend title to it from third parties. The beneficiaries in turn then have a personal right against the trustees for implementation and fulfilment of their duties as trustees to the beneficiaries.

This right of the beneficiaries is therefore enforceable against the trustees, not against the specific trust property. Scots law then applies a concept of ‘dual patrimony’ to deal with the separation of ownership of the trust property by the trustees, and the ownership of the trustees’ own personal property. The trustees will have a personal patrimony, which comprises their own legal rights, obligations and liabilities; separately,

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1 For the purposes of this article, all references to the law of England and Wales will be shortened to ‘English law’.
2 21 ER 485
3 s.25 Supreme Court of Judicature Act 1873
they have a trust patrimony, comprising the trust assets, obligations and liabilities. The trust patrimony is protected, and is not available to be claimed on by the trustee’s own creditors, who may only claim against the private patrimony of the trustee.

**STATUTE**

The main sources of trust law in Scotland are the terms of each specific trust deed, statute and common law.

The main sources of legislative provisions for Scottish trusts are the *Trusts (Scotland) Act 1921* (the 1921 Act), the *Trusts (Scotland) Act 1961* and the *Charities and Trustee Investment (Scotland) Act 2005* (the 2005 Act). However, these statutory powers laws are significantly more limited than those available to trustees of English trusts, and there is a default list of trustee powers set out in the 1921 Act. The powers are available to all trustees of Scottish trusts, provided that they are not at variance with the terms of the trust deed.

Modern trust deeds are typically drafted with extensive trustee powers, so that in practice trustees are not reliant on the fairly limited statutory powers of the 1921 Act. The powers are available to all trustees of Scottish trusts, provided that they are not at variance with the terms of the trust deed.

The powers of trustees in respect of investments were, however, extended considerably by the introduction of the 2005 Act, which provides that trustees of all Scottish trusts shall have the power to make any kind of investment (including in heritable property and real estate, notably absent from trustee powers prior to this Act), provided that it is not at variance with the terms or purposes of the trust.

There are also notable differences in terms of dispositive powers available to trustees through Scottish statute, as compared to that in England and Wales. Under English law, there exists a statutory power of advancement under s.32 of the *Trustee Act 1925* (the 1925 Act), allowing the trustees to pay or apply trust capital for the advancement or benefit of beneficiaries who are the object of the power. There is no equivalent statutory provision in Scots law, and such a power would only be available to trustees if it were specifically provided for in the trust deed.

A further example of a difference in this area is the power given to English trustees to delegate authority, as also set out in the 1925 Act, which authorises trustees to ‘delegate the execution or exercise of all or any of the trusts, powers and discretions vested in him as trustee’ by power of attorney. No equivalent general or statutory power exists in Scotland, and in fact there are significant limitations on this: one of the principal duties of a trustee of a Scottish trust is to act personally. While Scottish trustees do have an ability to appoint agents, this is not as extensive as the power to delegate widely under a power of attorney that exists in English law.

Scottish trustees may not delegate their discretionary functions and may only appoint agents to attend to administrative matters, as in the case of *Scott v Occidental Petroleum (Caledonia) Ltd*. In this case, the court determined that a mother who received damage payments on behalf of her two minor children could not transfer those funds into trust to be held and administered by third-party trustees. The court considered that the mother’s role in holding the funds for her children was analogous to that of a trustee, and that a

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4 s.4 1921 Act  
5 s.93 2005 Act  
6 s.32(1) 1925 Act  
7 s.25 1925 Act  
8 Under both common law and the statutory power in s.4(1)(f) of the 1921 Act.  
9 Scott v Occidental Petroleum (Caledonia) Ltd 1990 SC 201
trustee could not so delegate the powers entrusted to them.

LEGAL TERMINOLOGY
The language and terminology of trust law in Scotland and England and Wales differs, which can lead to confusion. In Scotland, the settlor is known as the ‘truster’, while a ‘liferenter’ is the equivalent to the English life tenant. ‘Fiar’ is the Scottish term for the remainderman, although it is now commonly replaced with ‘capital beneficiary’. In practice, these terms are commonly interchanged, particularly with the UK-wide taxation legislation, such as the Inheritance Tax Act 1984, which uses English terminology and contains provisions applicable to both Scottish and English trusts.

TYPES OF TRUST
English trust law allows for categories of trusts that are statutory and that do not exist under Scots law. One such example is the English protective trust, provided for in the 1925 Act. A protective trust is designed to provide a beneficiary with a life interest, but with the provision that such life interest would terminate in the event that they were to do anything to ‘alienate’ that interest, such as filing for bankruptcy or attempting to dispose of their interest in the trust by assignment or mortgage.

This type of trust is intended to address and manage concerns that a settlor may have in respect of the lifestyle, circumstances or financial responsibility of the life tenant. No such equivalent trust exists in Scots law, although the effect may be created through specific drafting of a Scots-law trust deed.

English trust law also provides for statutory trusts, which are created on intestacy. Again, there is no equivalent under Scots law, with the distribution of an intestate estate in Scotland not involving the creation of any trusts, with estate division on intestacy being outright to beneficiaries.

PERPETUITIES, ACCUMULATIONS AND SUCCESSIVE LIFERENTS
A perpetual trust cannot exist under English law, unless the trust is for charitable purposes.

‘Currently, the rule against perpetuities in England and Wales limits the perpetuity period of a trust to a maximum of 125 years’

The principle against perpetuities has been the position under English law since the end of the 17th century, being established in The Duke of Norfolk’s Case, where the Earl of Arundel sought to create an inheritance arrangement where property passed through multiple generations, including to those who were not yet born. The limitation on perpetuities is largely for reason of public policy, it being considered unconducive for a prosperous economy, or society, to have private wealth ring-fenced in a trust for an indefinite and potentially perpetual period. The rule against perpetuities in England and Wales currently limits the perpetuity period of a trust to a maximum of 125 years (unless it is a charitable trust, in which case the limitations on perpetuity do not apply).

Scots law does permit perpetual trusts; however, while assets may be tied up indefinitely in a trust, this is limited by restrictions on the accumulation of income in a Scottish trust and on the ability to create successive liferents.

The limitation on accumulation of income in a Scottish trust remains in place, having been first introduced by the Accumulations Act 1800 (the 1800 Act; there was formerly a similar limitation under English law, also originated from the 1800 Act, which has been abolished, except for charitable trusts). The relevant legislation in Scotland sets out six permitted periods of accumulation.

In practice, the most frequently encountered accumulation periods are 21 years from the date of the trust or 21 years from the date of the testator’s death, in the event that the trust is created under a

10 s.33 1925 Act
11 s.47 Administration of Estates Act 1925
12 Succession (Scotland) Act 1964
13 3 Chan Cas 1; 22 ER 931
14 Although the overall rule against perpetuities is still in place, the accepted period was extended by the Perpetuities and Accumulations Act 2009, which amended the maximum period permitted from 80 to 125 years.
15 s.5 Perpetuities and Accumulations Act 2009
16 At s.13
17 s.5 Trusts (Scotland) Act 1961, as amended by s.6 Law Reform (Miscellaneous Provisions) (Scotland) Act 1966
‘Scots law restricts the ability to create successive liferents in a trust. Broadly, this means that a liferent can only be created for a beneficiary who is either in life or in utero at the date the trust was created.’

will. Once the accumulation period has ended, the trustees are obliged to distribute all income.

The Scottish Law Commission has scrutinised this rule in its 2014 Report on Trust Law (the Report), and it has recommended that the rule be abolished, it being noted as giving rise to ‘issues of complexity, uncertainty and inconsistency’. Alongside the Report, the Scottish Law Commission also produced a draft Trusts (Scotland) Bill (subsequently updated in December 2018), which, if enacted, would repeal the legislation giving rise to restrictions on accumulation.

Scots law also restricts the ability to create successive liferents in a trust. Broadly, this means that a liferent can only be created for a beneficiary who is either in life or in utero at the date the trust was created. In the event that the beneficiary does not meet these criteria, then they will be entitled to the trust property at the age they would have been entitled to the liferent interest, unless they are under the age of 18 at the time when they become so entitled, in which case they instead become absolutely entitled on attaining the age of 18.

This can be an unexpected outcome for some trusts, bringing them to a conclusion earlier than intended, and potentially accelerating unanticipated tax consequences. It should be noted that this is another area considered in the Report, and the Scottish Law Commission has suggested that this rule be abolished. As with the restriction on the accumulation of income, the draft Trusts (Scotland) Bill includes provision for repeal of the legislation that currently prevents the creation of future interests. Interestingly, while the Scottish Law Commission is recommending the abolition of the rules restricting accumulation of income and creation of successive liferents, it also specifically recommends that Scots law not adopt any rule, such as the rule against perpetuities, that restricts the duration of the trust purposes to a fixed period or requires that vesting should take place within a fixed period. Therefore, it appears that the approach to perpetuity will continue to separate trust law in Scotland and England and Wales.

DECISION MAKING

Lastly, another key difference between trusts governed by Scots versus English law is the mechanism for trustee decision making. Under English law, the default position is that trustee decisions must be made unanimously, unless otherwise provided for in the trust deed; under Scots law, the default position is that trustee decisions may be made by majority, unless the contrary is provided for in the trust deed.

The position in Scotland does provide some additional flexibility, particularly in light of the limitation on delegation. However, the ability of English trustees to delegate authority through a power of attorney provides the necessary flexibility to deal with the need for unanimity at times when not all trustees may be available to act.

Each system therefore provides an element of balance to the limitations it has in place, which helps make those limitations more workable. For practitioners from other jurisdictions involved with trusts either in Scotland or England and

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18 s.18.15 the Report
19 s.9 1921 Act, as amended by s.18 Law Reform (Miscellaneous Provisions) (Scotland) Act 1968
20 s.18.44 the Report
21 s.18.44 the Report
22 s.3(c) the 1921 Act
Wales, it is important to be aware that, in order for a trustee decision to be binding, the mechanism for decision making must be checked in the trust deed, failing which the relevant default position would apply.

**THE REPORT**

As noted, the Scottish Law Commission has undertaken detailed analysis and consultation on Scottish trust law, seeking to ensure that Scottish trust law be ‘perceived as being suitable for use in contemporary financial and economic conditions’\(^23\), with there being a wide perception that the Scottish law of trusts is seriously outdated. The current law is based largely on legislation and case law that is no longer considered to be in line with the modern social and economic environment.

The work undertaken by the Scottish Law Commission to review the law in this area has been vast, with the publication of eight discussion papers, two consultations, two reports and a draft Bill.\(^24\) Along with those areas outlined in this piece, many of the wider proposed changes would see Scots law align more closely to trust law in England and Wales, while the fundamental trust concept would remain distinct between the two systems.

Similarly, the Law Commission of England and Wales intends to undertake a project, ‘Modernising Trust Law for a Global Britain’, which seeks to comprehensively review English trust law to ensure its suitability for modern society and business.\(^25\)

The UK holds a unique position in its multi-jurisdictional legal construction. Any practitioners dealing with clients or trusts affiliated with either England and Wales or Scotland must take note of the nuances of and differences between the two systems, to ensure that trustees are acting within their powers, decisions are made and trusts are administered in accordance with the legal requirements of the relevant jurisdiction.

**FIONA CLARKE TEP IS A SENIOR ASSOCIATE AT BURNESS PAULL**

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\(^{23}\) Chapter 1 the Report

\(^{24}\) Further information can be found at bit.ly/2HOdhaY

\(^{25}\) Further information can be found at bit.ly/2YCtTto
ABSTRACT

• Israel’s trust law applies to any trust relationship; however, the main route to create a private trust is by creating a hekdesh, also known as an endowment. The hekdesh is a document signed unilaterally by the settlor and can be executed either before a notary or as a last will and testament.

• Since a trust under Israeli law, including a hekdesh, is not considered a legal entity, common practice is to use an underlying company to hold the trust assets. The use of a hekdesh combined with an underlying company offers an efficient instrument for estate planning, contrary to a trust created by a contract between the settlor and the trustee.

• This article will review the trust under Israeli law, with an emphasis on the hekdesh and its use. It will also investigate the recognition of foreign trusts under Israeli law.

The legal system in Israel is known as a mixed legal system, since it incorporates elements from both common law and civil law. Its civil-law influences derive from the Ottoman Empire era, while the UK government introduced English principles of common law and equity during the British Mandate (1923–1948); these were then gradually replaced by new independent Knesset (Parliament) legislation and decisions of the Supreme Court of Israel (the Supreme Court) on the establishment of the Israeli state.¹

Trusts in Israel are provided for under the Trust Law, 5739–1979 (the Law),² s.1 of which defines a trust as ‘the duty imposed on a trustee to hold or to otherwise deal with assets under its control for the benefit of another, or for some other purpose’. Under s.2 of the Law, a trust can be created either in accordance with the law, by a contract between the settlor and the trustee.

In this article, we outline the principal types of trust, with particular attention paid to the hekdesh.
‘Section 42 of the Law provides that the provisions of the Law shall apply where no other Israeli law contains special provisions on the matter in question’

A TRUST CREATED UNDER LAW
A trust that is created in accordance with the law is a relationship that complies with the definition of s.1 that its terms and conditions are determined in legislation. Section 42 of the Law provides that the provisions of the Law shall apply where no other Israeli law contains special provisions on the matter in question. It therefore follows that, in the circumstances of a trust relationship subject to a specific law, the Law can be viewed as a complementary mechanism only.

TRUSTEES APPOINTED BY A JUDICIAL AUTHORITY
Scholar Shlomo Kerem sets out the four main characteristics of a trustee appointed by a judicial authority as follows:
• The scope of the trustee’s powers to act is determined by the legislation. The trustee receives control over the property by way of law, and they do not need any other legal means in order to execute their duties, such as a licence, ownership or any other right in the property.
• A special law sets out the modus of the appointing body and the powers, duties and obligations conferred to the trustee.
• The trustee’s demise terminates the powers of the acting trustee.
• The appointing authority may replace the trustee without need of transferring any right of ownership.

A good example of such a trustee is an estate executor appointed in accordance with the Succession Law, 5725-1965 (the Succession Law). Under ss.77 and 78, the court may appoint an executor, who, under s.82, is subject to the instructions of the court, and must assemble the assets of the estate, manage the estate, discharge the debts of the estate and distribute the balance of the estate among the heirs, in accordance with a succession order or a probate order, and do anything else necessary for the execution of the succession order or of the probate order. Further, under s.86, the executor must keep accounts and file reports to the Administrator General (AG) regularly.

ADMINISTRATIVE STATUTORY BODIES ACTING IN THE CAPTIVITY OF A TRUSTEE
These are bodies of the state that effectively act in the capacity of a trustee on behalf of the state in matters of need, such as those listed below:
• The AG as the Public Trustee: s.36 of the Law provides that the Minister of Justice shall appoint a Public Trustee, who may be appointed by the court as a trustee of trusts. Accordingly, the AG was appointed to act in the capacity of Public Trustee in 1985. In the case of the Public Trustee v Agmon, Justice Barak held that the court holds the authority to supervise the Public Trustee’s activity, and to give instructions when necessary to uphold the purposes of the trust, including instruction regarding the appropriate time to release the Public Trustee from office.
• The AG as the administrator of abandoned assets: according to s.2(b) of the Administrator General Law, the AG is responsible for the administration of abandoned assets. Section 1 defines an abandoned asset as an asset without a known owner, or without a person entitled to or capable of administering the asset, which has a connection to Israel: the asset is either situated in Israel or belongs to an Israeli resident, citizen or corporation.

TRUSTEES APPOINTED WITH THE CONSENT OF A GOVERNMENTAL REGULATORY BODY
Kerem points out the mutual characteristics of such consensual trustees:
• Legislation is limited to the minimum required to ensure the proper operation of the trustee.

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4 Succession Law, 5725-1965, 19 SH 215, §§ 77-78 (1964-65) (Isr.)
5 Government Notices 3250, 22/09/1985
6 PCA 0420/04 Pub. Tr. v Agmon 59(1) PD 627 (2005) (Isr.)
8 See note 3
‘Section 23 of the Contracts Law provides that a contract may be made orally, in writing or in some other form, unless a form is a condition of validity by virtue of law or agreement between the parties’

- Subject to the said minimum legislation, the parties are free to agree between them on the powers of the trustee, and its rights and obligations.
- The parties must confer on the trustee power and authorities by transferring the proprietary rights in the assets to the trustee, or by granting the trustee control and power over the assets.
  A debenture trustee, whose modus operandi is governed by the Securities Law, and a trustee of employee stock option incentive programmes, whose modus operandi is governed by the Income Tax Rules (Tax Relief in the Allocation of Shares to Employees), serve as good examples of such trustees.

A TRUST CREATED UNDER A CONTRACT
A trust created by a contract is one governed by the Israeli contracts laws and accordingly requires an agreement between the settlor and the trustee. Under this framework, a trust contract can be viewed as being established for the benefit of a third party in accordance with s.34 of the Contracts (General Part) Law, 1973 (the Contracts Law), thereby granting the beneficiary a right to enforce the trust contract.

Goren J affirmed this in the case of Arnon v Pieutrekovsky, stating:

“A transaction shall be regarded as a trust transaction subject to the provisions of the Trust Law if the conditions of the definition stipulated in the Law have been materially fulfilled. The applicability of the definition of a trust on a transaction is not subject to the mere wishes of the parties, and despite using the phrase “trust” in the transaction between them, the transaction shall not be a trust transaction and subject to the provisions of the law if its contents do not go in line with the definition of the trust in the Law.”

As mentioned above, s.23 of the Contracts Law provides that a contract may be entered orally, i.e. without a written document. Therefore, a trust relationship may be created by the mere behaviour of the parties. This is commonly known as an ‘implied trust’. Shamgar J addressed this issue in the case of Wallas v Gat, stating the following:

“‘The Implied Trust was created in the Common Law to deal with circumstances where the behavior of the parties and their actions imply that they intended to create a trust, but for some reason, this intention was not explicitly expressed ... It is implied from their relationship and forth in s.1, it therefore follows that, to determine whether a contract can be regarded as a trust contract, the nature of the relationship between the parties should be examined.”

12 File No. 548/06 District Court (Tel Aviv), Arnon v Pieutrekovsky (30 June 2013), Nevo Legal Database (by subscription) (Isr.)
13 See note 3
14 CA 3829/91 Wallas v Gat 48(1) PD 801, 810 [1994] (Isr.)
‘While the transfer of assets to a trustee during the lifetime of the settlor does not usually give rise to any special difficulties, this may not be the case when a testamentary trust is concerned’

behavior, that although the asset is registered under the name of one of them, the beneficial ownership belongs to the other.

A TRUST CREATED BY DEED OF HEKDESH (ENDOWMENT)
Section 17 of the Law deals with the creation of a hekdesh, and provides in s.17(a) that a hekdesh is created when a property is dedicated in favour of a beneficiary or for some other purpose by a written document, in which the hekdesh’s creator expresses their intention to create the hekdesh and determines its objectives, property and conditions, and when such written document takes one of the following forms:

• A written document signed by the hekdesh’s creator before a notary. A trust created in this manner is commonly known as an inter vivos trust under Israeli law.
• A written will from the hekdesh’s creator, created in accordance with the Succession Law, which provides that a written will can be made before two witnesses, the court or a notary, or in the handwriting of the testator. A trust created in this manner is commonly known as a testamentary trust under Israeli law.
• A payment instruction in accordance with s.147 of the Succession Law, which provides that payments made to beneficiaries under an insurance policy are not included in one’s estate. Accordingly, the setting out of beneficiaries in an insurance policy is regarded as a hekdesh.

COMMENCEMENT OF A HEKDESH
Section 17(b) of the Law provides that the hekdesh shall become effective on the transfer of control of the hekdesh property to the trustee. Accordingly, an inter vivos trust commences on the transfer of the trust assets to the control of the trustee, and a testamentary trust commences on the issuance of a probate order with respect to the will, which effectively transfers the assets to the control of the trustee.

While the transfer of assets to a trustee during the lifetime of the settlor does not usually give rise to any special difficulties, this may not be the case when a testamentary trust is concerned. Section 54 of the Succession Regulations, 1998 provides that a copy of an application for a probate order shall be submitted to the review of the AG, which may, at its discretion, conduct additional inspection of the application and request further information and documents. Further to that inspection, the AG may also intervene in the probate procedure and effectively alter the terms and conditions of the testamentary trust set forth by the testator.

A DECLARATION OF A HEKDESH BY THE COURT
Section 17(c) further provides that, when any property is de facto a hekdesh, but no instrument of hekdesh exists with respect thereof, the court may declare the existence of a hekdesh and may determine its objectives, property, conditions and date of commencement.

In the case of Weinstein v Fox, the testator bequeathed his entire estate to his children, who were resident in the US, on the provision that they immigrate to Israel, and that all the assets of the estate and the income derived therefrom remain in Israel. Under these circumstances, the executor of the estate, Advocate Fox, applied to the court to release him from his position of executor of the estate, but simultaneously appoint him as trustee with respect to the assets under his control for the period until the children of the deceased immigrate to Israel. Ultimately, the Supreme Court approved his appointment as trustee and declared the existence of a hekdesh under s.17(c).

15 9 LSI 215 (1964–1965) (Isr.)
16 Succession Law
17 KT 5923 (Isr.)
18 A governmental department within the Ministry of Justice, which inter alia supervises inheritance guardianship and charity procedures in Israel.
19 CA 5777/95 Weinstein v Fox 54(5) PD 792 [2000] (Isr.)
TRUSTS IN ISRAEL  DR ALON KAPLAN AND MEYTAL LIBERMAN

‘A trust pursuant to contract, where one of its objectives is the furtherance of a public purpose, would be considered as a public hekdesh, and therefore subject to registration with the registrar’

THE CHARITABLE TRUST: THE PUBLIC HEKDESH

As regards charitable trusts, s.26 of the Law provides that:

‘A trustee of a trust, the objective or one of the objectives of which, is the furtherance of a public purpose (hereinafter: public hekdesh) shall, within three months from the date on which he becomes a trustee, inform the Registrar of the existence of the hekdesh and of the particulars enumerated hereunder, unless notification thereof has been made previously, and he shall inform the Registrar of any change in those particulars within three months of the date thereof. Notification of the existence of a public hekdesh shall be accompanied by a copy of the instrument of hekdesh.’

As evident from the wording of this section, such a public hekdesh is not required to meet the conditions of s.17 of the Law. Hence, a trust pursuant to contract, where one of its objectives is the furtherance of a public purpose, would be considered as a public hekdesh, and therefore subject to registration with the registrar.

USE OF COMPANIES

The trust, including the hekdesh, is not recognised as a legal entity in Israel,20 and, therefore, a common practice of trustees is to hold the assets of a trust via an underlying company incorporated in accordance with the provisions of the Income Tax Ordinance (New Version), 5721-1961 (the Ordinance),21 thereby creating a designated legal entity to hold the hekdesh assets on behalf of the trustee.

According to the Ordinance, such an underlying company is defined as a company that holds trust assets for the trustee, whether directly or indirectly, in accordance with the terms set forth below:

- That the underlying company is incorporated solely for the purpose of holding the trust assets.
- That notice of the incorporation of the underlying company be provided to the tax authority within 90 days of the underlying company’s incorporation where it is an underlying company of the following trusts:
  - an Israeli resident trust;
  - an Israeli resident beneficiary trust;
  - a testamentary trust of which an Israeli resident is a beneficiary; or
  - any trust in which the trust assets are in Israel.

TRUSTS AND ESTATE PLANNING

A trust, properly set up, can serve as a good mechanism to transfer assets to the next generation. To understand the advantages of a trust for estate-planning purposes in Israel, the difficulties and complexity of the inheritance procedure in Israel should first be demonstrated.

Under the Succession Law, the rights of the heirs in the estate are created only on the issuance of order with respect to the estate by the competent authority. In circumstances where the deceased left a will, an application should be made for a probate order, and only on the issuance of the order does the will become valid and enforceable. It should also be noted that only a probate order issued in Israel in accordance with the Succession

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20 PCA 46/94 Zacks-Abramov v Land Registry Officer 50(3) PD 202 (1996) (Isr.)
Law is regarded as valid, and probate orders issued by foreign authorities are invalid.\(^{22}\)

However, in circumstances where the deceased left a will relating to only a part of their estate, or the deceased did not leave a will at all, an application should be made for an inheritance order.\(^{23}\)

Both an application for a probate order and an application for an inheritance order are made to the Registrar of Inheritance, which is authorised to declare the rights of the heirs accordingly.\(^{24}\)

However, in the circumstances described in s.67A of the Succession Law, the Registrar of Inheritance must forward the application to the relevant court. Such circumstances arise, for example, when the application is contested, when the will is defected, or when the AG represents a minor in the application. The court is authorised accordingly to issue the relevant order.\(^{25}\)

Probate procedure in Israel requires that the original will be submitted with the Registrar of Inheritance, except for an oral will. In the absence of an original will, such as when the original has already been submitted in another jurisdiction, a separate application should be made to the court to approve the submission of a copy.\(^{26}\)

Section 54 of the Inheritance Regulations (the Regulations)\(^{27}\) provides that a copy of any application, including an application for a probate or inheritance order, shall be submitted to the review of the AG, which may, in its discretion, conduct additional inspection of the application and require further information and documents.

Section 17 of the Regulations requires that a notice with respect to the application for the inheritance or probate order be published in one daily newspaper and in the formal publication of the State of Israel (Reshumot). The notice includes an invitation to contest the application.

Section 14(b)(4) of the Regulations provides that an application for a probate or inheritance order shall be dismissed unless a registered mail certificate or an affidavit were attached to the application, which confirms that a notice on the submission of the application has been delivered to the heirs under law, the beneficiaries under a will or the deceased’s family members, as set forth below:

- In the case of an inheritance application: a notice on the submission of an application for an inheritance order shall be delivered to all heirs listed in the application, and shall include the portion of each of them in the estate.
- In the case of a probate application: a notice on the submission of an application for a probate order shall be delivered to all beneficiaries under the will, together with a copy of the will. If the beneficiaries under the will do not include the children of the deceased or their children, the parents of the deceased or their children, or the spouse of the deceased, such notice shall be delivered, in addition, to the children of the deceased and to the person who was the deceased’s spouse at the time of their death. If the deceased left no spouse or children, such notice shall be delivered to the deceased’s parents, and if the deceased left no parents either, then such notice shall be delivered to their sibling.

The inheritance procedure in fact allows the scrutiny and intervention of the court, where otherwise such would be avoided, thereby effectively changing the instructions of the testator. In the case of The Estate of the deceased GB v The Administrator General,\(^{28}\) the deceased left a will where he bequeathed his estate to a hekdesh, whose purpose was the well-being of his two incapacitated sons. The deceased appointed two trustees for the hekdesh. On the demise of the deceased, one of the trustees was appointed as a guardian of the two sons. The Family Court of Tel Aviv (the Court) held that a guardian, due to their responsibility and the trust given in them by the court to take care of the incapacitated person, is subject to more supervision in comparison to a trustee, who is independent and exercises discretion in the management of the trust. Therefore, the Court held that both trustees are to be subject to the supervision of the AG as if both have been appointed as guardians.

Another important issue relating to estate planning concerns s.8(b) of the Succession Law, which provides that a gift granted by a donor

\(^{22}\) Succession Law, § 39
\(^{23}\) At § 66
\(^{24}\) Ibid
\(^{25}\) At § 67A(b)
\(^{26}\) At § 68(b)
\(^{27}\) Inheritance Regulations, 1998, KT 5923 (Isr.)
\(^{28}\) File no. 12695/06 Family Court (Tel Aviv) The Estate of the deceased GB v The Administrator General (Apr. 16, 2008) Nevo Legal Database (by subscription) (Isr.).
during the donor’s lifetime, when such gift is to be effectively provided to the donee after the donor’s demise, is null and void, unless such gift was included within a valid will.

In the case of *Doe v Doe*, the deceased made several wills and one draft of will prior to his demise. In the first wills, the deceased bequeathed his estate mainly to his family members, whereas in the last two wills and the draft will he bequeathed his estate to another person, and instructed that the two persons whom had been added as co-owners to his bank account execute certain payments, which were not expressly stated in the wills.

The Supreme Court determined that the written and executed wills of the deceased were void due to unjust influence, and the addition of the co-owners to the bank account was made unlawfully, and was therefore also void. Under these circumstances, the court held that no *hekdesh* was properly set up.

It was further argued that a trust had been created by an oral contract in accordance with s.2 of the Law. The Supreme Court held that the purpose of the deceased was to set up an arrangement of payments to be executed on his demise; therefore, it did not accord with s.8(b) of the Succession Law, which requires that such arrangements be set up by will. The Supreme Court continued and held that the creation of such trust should have been made in accordance with s.17 of the Law.

As evident from the above, the inheritance procedure in Israel is a complex and cumbersome procedure. It may also be uncomfortable for the deceased’s family members, who are required to disclose the contents of the will. Due to this reason, it is usually advisable to set up an *inter vivos* trust, rather than a testamentary trust, and special attention should be paid to the transfer of assets into the trust in order to avoid a situation where such transfer is struck down by the court under s.8(b), as mentioned above.

**RECOGNITION OF FOREIGN TRUSTS AND TRUST-LIKE STRUCTURES IN ISRAEL**

Several different wealth management or legacy structures can be found in operation in Israel. These structures include not only common-law trusts, but also foundations, establishments and settlements made under the laws of other jurisdictions. Evidence on the operation of foreign trust-like entities in Israel can be found in the records of the Israeli Registrar of Companies as foreign corporations.

Further, s.75C of Israel’s *Income Tax Ordinance (New Version)*, 5721-1961 (the Income Tax Law) defines a trust as an arrangement according to which a trustee holds the trust’s assets in favour of a beneficiary, which was established in Israel or outside Israel, whether it is defined under the law applicable to it as a trust or whether defined otherwise.

The Income Tax Law further provides that a trustee is ‘a person to whom assets or income of assets are attributed, or who holds assets in trust ... For this purpose ... a legal entity listed in the First Schedule A shall be regarded as a trustee; the Minister of Finance may, by order, add corporate bodies to First Schedule A.’

The legal entities listed in said First Schedule A are the following:

- a foundation under the laws of Liechtenstein, Panama, the Bahamas, and the Netherlands Antilles (Curaçao);
- an establishment under the laws of Liechtenstein; and
- a registered trust enterprise (trust reg.) under the laws of Liechtenstein.

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29 File no. 7053/15 Supreme Court, *Doe v Doe* (1 September 2016) Nevo Legal Database (by subscription) (Isr.)
30 Section 20 of the Succession Law provides that a will made as a result of unjust influence – i.e. not out of free will – is void.
31 A review of the records of the Registrar of Companies shows, for example, a company named ‘Favorit Establishment’, which was incorporated on 19 November 1967 in Liechtenstein.
The fact that foreign trusts are recognised under Israeli law is demonstrated more forcefully in the case of *Lnl Reg Trust v Levine*, where a trust entity litigated in the Israeli District Court (the District Court). In this case, the trust entity, Lnl Reg Trust, was established in 1965 for holding assets and the administration thereof for a family. A dispute arose with respect to the validity of a certain document executed by the founder, where he left instructions to the trustee, since it was not probated as a will.

The importance of this case lies in the fact that the legal capacity of a Liechtenstein trust reg. entity was effectively recognised by the Israeli District Court, since it was able to file a claim and litigate in Israel. Further, the District Court reviewed the by-laws of the trust entity and other legal arrangements within the trust and determined the rights of the beneficiaries accordingly.

**TAX CONSIDERATIONS**

Under the Income Tax Law, trusts with an Israeli-resident settlor, or an Israeli-resident beneficiary, or that have assets situated in Israel, are subject to reporting and tax in Israel. As can be inferred, the location of the trustee is irrelevant for this purpose. The transferring of assets to a trust, whether a testamentary trust or an *inter vivos* trust, may, however, impose reporting and tax obligations on the trustee.

It should be noted that there is no gift or estate tax in Israel, and, should a person decide to transfer their assets by way of inheritance to a trustee in accordance with the Succession Law, or by way of will, the transfer would not be considered a tax event in Israel, regardless of the nature of the assets.34

The Ordinance provides for tax benefits to new immigrants and long-term returning residents, namely an exemption from tax and reporting obligations for a period of ten years on all forms of income, active or passive, as long as they are derived from sources abroad. These benefits may be applied to a trust of such new immigrants and long-term returning residents accordingly.

**CONCLUSION**

The Israeli trust institution, which has its foundations in Israeli case law, became statutory on the enactment of the Law in 1979, and has since continued its development through court cases.

The above analysis demonstrates that a trust can be considered as an efficient instrument to plan an estate, as it both minimises the need for inheritance procedures and allows a greater degree of control over the assets, provided it is set up properly.

For this purpose, it is therefore recommended to set up a trust in accordance with the procedure set out in s.17 of the Law, preferably as an *inter vivos* trust that does not require probate proceedings. The trust instrument should be drafted carefully, with special care given to future events that may occur, such as death and divorce of beneficiaries. It is also highly recommended to use an underlying company to hold the trust assets, thereby holding them by a designated separate legal entity. The transfer of the assets to the underlying company can be made either during the lifetime of the settlor or by way of succession to the trustee or underlying company as heirs. Although it is usually preferred to transfer the assets during the life of the settlor, the type of assets and the tax consequences of the transactions should also be considered.

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33 File no. 1527/96 District Court (TA) Lnl Reg Trust v Levine (2 January 2008) Nevo Legal Database (by subscription) (Isr.)

34 It should be noted that, in the case of a sale of a real property that was received by way of inheritance, the *Taxation of Real Property Law (Capital Gains and Purchase), 5723-1963, 17 SH 195 (1963)* (Isr.) provides that the time period in which the property was owned by the deceased is taken into account when capital gains tax due is calculated.
RECOGNITION OF TRUSTS IN ITALY

PAOLO LUDOVICI

FOREIGN TRUSTS IN ITALY

The legal and tax ramifications

BY PAOLO LUDOVICI

ABSTRACT

- Italy’s legal framework does not provide for a set of laws regulating the settlement and existence of trusts. Nevertheless, trusts established and governed under foreign laws are legally recognised in Italy, provided they are in compliance with the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, and are subject to a specific body of tax legislation.

- From a practical perspective, the trust has become a useful instrument for many Italian high-net-worth individuals in dealing with their wealth planning.

- This article describes the main legal and tax ramifications to trusts, their settlors and their beneficiaries in Italy, including: the recognition of trusts in Italy for civil-law purposes; the treatment of trusts for income tax purposes; and the treatment of trusts for inheritance tax purposes.

Italy’s civil-law system does not provide for a set of laws regulating the settlement and existence of trusts, with the consequence that it is not possible to establish a trust (or any similar instrument) under Italian law. However, Italy did ratify the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition (the Convention) by way of Law n. 346 of 16 October 1989, and trusts established and governed under foreign laws are therefore legally recognised in Italy, provided that they comply with the requirements set forth by the Convention and are not set up to defraud creditors.

The Italian legal framework is therefore familiar with trusts, which are considered to be fully legitimate legal instruments. Indeed, Law 27 December 2006, n. 296 introduced into the Italian income tax code (the Code) by way of Presidential Decree 22 December 1986, n. 917 specific rules for trusts and beneficiaries, and thereafter several official guidelines have been issued by the Italian tax authorities. More recently, Law n. 22 June 2016, n. 112, expressly included trusts among certain instruments that may benefit from an advantageous tax regime.
in cases where they are established in favour of individuals suffering from disabilities and specific medical conditions.

Areas of uncertainty still exist, however, and in particular several issues may arise as a consequence of the lack of specific provisions that coordinate the application of certain rules provided by Italy’s inheritance law and family law to situations involving trusts. Some of these issues might be resolved in the near future: the Italian government has recently promoted a Bill of Law (Delega al Governo per la revisione del codice civile, the Bill) that, if approved by parliament, should lead to an extensive revision of the current legislation, including the introduction of specific rules that should regulate the establishment and functioning of trusts under Italian law.

THE TREATMENT OF TRUSTS FOR INCOME TAX PURPOSES

TAX RECOGNITION OF TRUSTS

Based on the Code and the guidelines provided by the Italian Agency of Revenue (Agenzia delle Entrate, the Agency), trusts may fall under three different categories for income tax purposes:

• interposed (or ‘disregarded’) trusts;
• transparent trusts; and
• opaque trusts.

Interposed trusts are those instruments that, regardless of their validity from a legal standpoint, are disregarded for income tax purposes, e.g. because the settlor has not genuinely relinquished control over the assets transferred to the trusts. In such a case, the tax treatment of income arising from the assets comprised in the trusts’ fund shall be determined as if the trust had never been established.

The Agency has compiled a list of cases that may be referred to as an ‘index’ of instances where the settlor (and, in certain cases, also the beneficiary) has not ceded control of the management of the trusts, and this list includes:

• trusts where the settlor (or the beneficiary) has the power to terminate the trust at any time on their own initiative for their own benefit or the benefit of third parties;
• trusts where the settlor (or the beneficiary) has the power at any time to appoint themselves as beneficiary;
• trusts where, based on the trust documents or the factual matrix, it would appear that the trustee has discretion in relation to the administration of the trust, but may not exercise any power without the consent of the settlor (or the beneficiary);
• trusts where the trustee has to take into account the settlor’s indications in relation to the administration of the trust assets and the related income;
• trusts where the settlor has the power, during the life of the trust, to change the beneficiaries;
• trusts where the settlor has the power to assign trust assets or to give out loans; and
• any other scenario in which the dispositive powers of the trustees (as conferred by the trust deed or the law) are somehow limited or conditioned by the wishes of the settlor and/or the beneficiaries.

If a trust is not interposed, it qualifies as an autonomous taxpayer that may be treated as either a ‘transparent’ or an ‘opaque’ trust.

A transparent trust is where the trust deed provides for an enforceable right of the beneficiaries to obtain the distribution of the trusts’ income. In such cases, the taxable income is determined at trust level and, to the extent it is not formed with proceeds already subject to Italian final taxation at source, is subject to taxation in the hands of the beneficiaries under the ordinary progressive income tax (IRPEF), applying at rates ranging from 23 to 43 per cent plus additional local taxes, regardless of its distribution. The subsequent distribution to the beneficiaries of the same taxed income is not subject to any further taxation.

1 Contained in Circular letter 10 October 2009, n. 43/E and Circular letter 27 December 2010, n. 61/E.
An opaque trust is where the trust is not deemed to be transparent. The taxable income is determined on the basis of the same rules provided for private individuals and described above, and is then subject upon the same trust to corporate income tax (IRES), currently applying at the rate of 24 per cent. As for the subsequent distribution to the beneficiaries, please see the paragraph ‘Distributions to beneficiaries’ below.

Trusts can qualify as partially transparent and partially opaque, where the beneficiaries are granted the right to obtain the distribution only of a portion of the trust’s income.

**TAX RESIDENCE**

The tax residence of trusts for income tax purposes has to be determined in accordance with the general rules for legal persons provided by art.73 of the Code, which provides that ‘entities are deemed to be resident in Italy if, for the majority of a tax year, they have in Italy their legal seat or their place of management or their main object’. Since the ‘legal seat’ criterion is not applicable for trusts, the two effective tests to determine the tax residence remain the place of effective management and the main object (i.e. the place where the core activities of the trusts are performed).

According to the stated position of the Agency, where the trust’s estate is composed of financial assets and shareholdings, reference should be made to the tax residence of the trustee and the place where the main activity of the trust is effectively carried out respectively, which in most cases will coincide with the place of residence of the trustee.

Article 73 of the Code also provides a presumptive rule, according to which trusts established in non-whitelisted jurisdictions are deemed to be tax resident in Italy for income tax purposes (unless proof of the contrary is provided) where:

- the trust is set up by at least one Italian-resident settlor for the benefit of at least one Italian-resident beneficiary; or
- the trust is set up by at least one Italian-resident settlor who transfers in favour of the trust the ownership of an immovable property situated in Italy.

A trust will be either resident or non-resident for the entire year, as no split-year mechanism is applicable under Italian tax laws. Where a trust is resident in Italy, all its income will be subject to all domestic income taxes and this will also apply for ‘transparent trusts’, regardless of the country of residence of the beneficiaries, as the income will be imputed into the hands of beneficiaries, even though they are non-resident. If a trust is instead resident outside Italy, it will be liable to income taxes only with respect to Italian-source income.

**TAXATION OF INCOME**

With the exception of commercial trusts (which are very unusual), income generated by the trust is determined based on the same rules applicable to private individuals and any non-commercial entity. Under such rules, items of income are taxable only if they fall within one of the following categories:

- income from immovable assets;
- income from capital investment;
- income from employment and pension;
- income from self-employment;
- business income; and
- capital gains and other miscellaneous income.

Taxable annual income is determined as the sum of the items of income realised in each of these categories and is then subject to either 24 per cent IRES in the hands of the trust if ‘opaque’ or ordinary progressive IRPEF in the hands of beneficiaries if ‘transparent’.

The main tax ramifications that would likely concern trusts established by families and

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2 Circular letter n. 48/E of 6 August 2007

3 To include IRES, IRPEF, withholding or substitutive taxes, plus local additional taxes.

4 The same rules apply to non-resident entities, commercial and non-commercial, including non-resident trusts.
individuals in Italy to handle their personal assets typically concern financial assets, real estate or property, and works of art.

With a few exceptions, financial assets are subject to a withholding, or substitutive, tax at the rate of 26 per cent. Dividends are not subject to the 26 per cent withholding tax, but will form part of the aggregate income of the trust to the extent of either 77.74 per cent of their amount, if produced up to 31 December 2016, or 100 per cent if produced from 1 January 2017. Proceeds from investment funds that are not compliant with the EU Undertakings for the Collective Investment in Transferable Securities,5 and whose fund manager is not subject to supervision in an EU or European Economic Area whitelisted state,6 are included in the aggregate income of the trust at 100 per cent.

Capital gains deriving from the disposal of immovable property or real estate are exempt if the property sold had been owned for more than five years. In general, rents are included in the ordinary income subject to IRPEF. However, rents of dwellings to private individuals may benefit from a 21 per cent substitutive tax.

Any capital gains deriving from the disposal of art works are, in principle, not subject to income taxes, provided that they are not realised within a business activity.7

DISTRIBUTIONS TO BENEFICIARIES

In the case of transparent trusts, the income of the trust already subject to taxation in the hands of the beneficiaries will not be subject to further taxation when distributed to the beneficiaries. As for opaque trusts, Italian tax laws do not include any provision dealing with the distributions of income from trusts (resident or not resident). As such, much of the guidance on the issue is derived from interpretation.

The common understanding is that distributions from trusts are not included among the taxable items of income and so are not subject to income taxes. The only exception may concern situations in which the distributions are structured as annuities (where the beneficiaries are granted with the right to receive a fixed amount periodically).

This interpretation was also shared by the Agency,8 which confirmed that distributions of income from opaque trusts to beneficiaries are not subject to any income tax, given the need to avoid a double taxation of the income already subject to tax in the hands of the trust itself, as outlined above. However, such clarifications do not specifically deal with distributions from non-Italian-tax-resident trusts and, in a number of tax audits, officers have considered distributions made by non-Italian-tax-resident opaque and discretionary trusts as taxable.

Distributions of capital from trusts are also not subject to any specific law provisions. However, such distributions, as distinct from income distributions, can be reasonably considered to be untaxable if it can be proved that the distribution refers to the capital initially transferred by the settlor to the trust. In addition, given the absence of specific rules on the matter, the trustee can freely decide to distribute capital to beneficiaries, even in cases where accumulated profits exist.

THE TREATMENT OF TRUSTS FOR INHERITANCE TAX PURPOSES

Italian inheritance tax (IHT) and gift tax applies to:

- assets and rights, wherever situated, transferred by virtue of gift or by succession if the donor/deceased is resident in Italy at the time of the gift/demise; and
- assets and rights situated in Italy, transferred by virtue of gift or by succession if the donor/deceased is not resident in Italy at the time of the gift/demise.

5 Directive 2009/65/EC
6 One that is deemed to be cooperative with EU anti-money-laundering and counter-terrorist-financing initiatives (as contrary to non-cooperative or ‘blacklisted’ states).
7 For more on the tax ramifications of collecting art in Italy, see Paolo Ludovici, ‘Questions of Interpretation’, STEP Journal (Vol27 Iss4), p.58
8 Circular letter n. 48/E of 6 August 2007
IHT and gift tax is currently applicable at the following rates:

• 4 per cent on transfers in favour of the spouse and lineal relatives exceeding EUR1 million per beneficiary;
• 6 per cent on transfers in favour of the siblings exceeding EUR100,000 for each beneficiary;
• 6 per cent on transfers in favour of other relatives up to the fourth degree of kinship; and
• 8 per cent on transfers in favour of all the other subjects.

Italian IHT and gift tax is also due with respect to the establishment of segregation deeds (vincoli di destinazione), including trust settlement deeds. In particular, according to the interpretation of the Agency, trust settlements shall be regarded as a gratuitous transfer from the settlors to the beneficiaries so that, for the purpose of IHT and gift tax:

• the transfer of assets into the trust, implying the segregation of the assets from the settlor’s estate and their destination to the benefit of the trust’s beneficiaries, triggers the application of IHT and gift tax (the tax rate being determined on the basis of the degree of kinship between the settlors and the beneficiaries); and
• the subsequent distributions of assets from the trust to the beneficiaries (even if the value of the assets has in the meantime increased or the held assets have changed) are not subject to IHT and gift tax, as the tax was applied on the ‘unitary’ transfer from the settlor to the beneficiaries at the time of the settlement.

Based on the Agency guidelines,9 this regime also applies to revocable trusts or trusts where the settlor also acts as trustee with the 8 per cent tax rate, even though they are not recognised for income tax purposes. A disregarded trust for income tax purposes may thus be considered as effective for IHT and gift tax purposes.

This thesis of Italian tax authorities is not supported by many authors and practitioners, according to whom the IHT and gift tax would not be applied to transfers of assets to the trust, but only to the subsequent transfer to the beneficiaries. Based on such an interpretation, many taxpayers have in fact challenged the liquidation deeds of the tax authorities that claimed for the application of the gift tax on the transfer of assets to the trust. Other taxpayers have instead decided to comply with the position of the tax authorities, viewing the application of the tax as an opportunity for tax planning (so anticipating the succession by benefiting from the current Italian IHT and gift tax regime, which is considered one of the most favourable in Europe, and which might change in the future with an increase of tax rates and, more generally, restrictive rules in terms).

Italy’s Supreme Court of Cassation (the Court) has not yet succeeded in reaching a definitive verdict and has issued many varying judgments, some in favour of the tax authorities’ interpretation, and others in favour of the taxpayers.

With the 2018 judgment in the case n. 31445, followed by the 2019 judgment in n. 734, the Court returned to the subject of the application of the gift tax on the contribution of assets to trusts, and set forth a new jurisprudential interpretation that might represent a compromise between the two opposing theses. According to these recent judgments:

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9 Circular letter n. 3/E of 22 January 2008
• the transfer of assets to the trust would not be taxable when it has a transitory nature; and
• the transfer of assets to the trust would, instead, be taxable when it produces a stable decrease in the assets of the settlor and therefore the transfer of assets to the trustee entails ‘the real enrichment of the beneficiaries, without providing for any possible return of the assets to the settlor’.

On the basis of these principles, the gift tax would be due in the case of all those trusts where the settlor genuinely contributed the assets to the trust in the interest of the beneficiaries and without the possibility of receiving the assets back themselves.

CONCLUSION
The use of trusts in Italy has steadily increased over the years. A number of Italian high-net-worth individuals have established trusts under foreign laws and then have had these administered by Italian trustees, to be treated as Italian income tax-resident instruments.

A familiar and non-hostile legal and tax environment, a growing number of trust service providers, and the absence of any other comparable instrument within the Italian legal framework that might be considered in the context of complex succession planning are all major factors that have contributed to the spread of trusts in Italy. Such trend is likely to continue in the future, particularly if parliament approves the aforementioned Bill proposed by the government. The Bill sets forth specific rules regarding the regulation, establishment and functioning of trusts and, more generally, solves many of the uncertainties concerning their use.
WHEN IS A TRUST NOT A TRUST?

Continental property arrangements and English real estate

By Richard Frimston and Paolo Panico

Abstract

• Although Tolstoy wrote that ‘each unhappy family is unhappy in its own way’, clients around the world face similar problems and dilemmas; while legal systems based on common law often solve these with the use of trusts, civil-law systems will use different trust-like structures, such as usufructs, fidéicommis, matrimonial property regimes or life insurance.

• In this article, the authors highlight two contrasting cases in which civil-law structures have interacted with UK taxation and the law of England and Wales, and consider the future comparison of trusts and ‘trust-like structures’ under the EU’s Fifth Anti-Money Laundering Directive.

A woman marries a member of a wealthy Luxembourg family. The couple settles down in a house in the UK, registered in the name of the husband and his father with a right of survivorship. Unfortunately, the marriage does not last. During the divorce proceedings, the estranged wife seeks an order in relation to the matrimonial home. She is unsuccessful, as the property was not beneficially owned by the husband or his father, but by a Luxembourg trust-like structure comprising the family’s assets.

At first sight, this story might sound like a familiar, if egregious, case of continental Europeans failing to grapple the intricacies of the land and trust law of England and Wales.1 However, in this case, HRH Tessy Princess of Luxembourg v HRH Louis Xavier Marie Guillaume Prince of Luxembourg,2 the opposite is the case. The issue

1 With apologies to all Welsh everywhere, all subsequent instances of ‘England and Wales law’ will be shortened to ‘English law’.
2 [2018] EWFC 77
TRUST-LIKE STRUCTURES RICHARD FRIMSTON AND PAOLO PANICO

underpinning the decision, handed down by the High Court of England and Wales (Family Division) (the Court), was not the enforcement of English trust law over real estate in continental Europe, but the interaction between a continental trust-like structure, the *Großherzogliches Fideicommis*3 or *fidéicommis grand-ducal*, and a property in London. This article will attempt to highlight the legal issues it raises. Before entering into the factual and legal details of the Court’s decision, we will focus on another recent case where a continental European property arrangement faced unfavourable tax consequences in the UK, and some historical aspects of the trust-like structure in question. We will then focus on the issue of beneficial ownership of the property.

FRENCH USUFRUCT AND ENGLISH CGT: A CAUTIONARY TALE

A clash between continental European property arrangements and English tax rules had already occurred shortly before the Court commenced its hearings in the case of HRH Tessy. The case of Francoise Findlay v The Commissioners for HMRC4 concerned the treatment of a French usufruct (usufruit) for UK capital gains tax (CGT) purposes. On 31 March 1982, Ms Findlay’s mother, a French national, had made a gift of the bare title (nue-propriété) of certain properties in Paris over which she had reserved back a right of usufruct. Ms Findlay’s mother died on 26 September 2007, on which date her usufruct lapsed and the full title on the properties vested in her daughter was freed from the usufruct. Her Majesty’s Revenue and Customs (HMRC) contended that CGT on such properties should be calculated based on their acquisition cost in 1982, and not that of 2007. The difference was clearly very significant. More significantly, it was argued that the basis for capital gains would have been 2007 (the year of Ms Findlay’s mother’s death), and not 1982, if her mother had opted for the equivalent Scots-law arrangement of a ‘proper liferent’, where she would have gifted her daughter the ‘fee’ of such properties while retaining a ‘liferent’, which is a direct equivalent to the right of usufruct.5 Similarly, a life interest in property held on an English trust, or a life interest under a legal interest limited for life under the law of Northern Ireland, could also have had the same effect for tax purposes if qualifying as an immediate post-death interest (IPDI) trust.

For UK inheritance tax purposes, by contrast to its position for CGT purposes, HMRC still maintains that a French *usufruit* should be taxed as if it were a trust. This difference in treatment itself creates many difficulties and exposes an obvious lack of coherence between the two taxes. The HMRC Capital Gains Manual states: ‘A usufruct governed by French law would be regarded as a non-trust arrangement as it is broadly similar to a Scottish proper liferent.’6 This statement produces the contradictory results that, although the *usufruit* is regarded by HMRC, correctly, as ‘broadly similar to the Scottish proper liferent’, it is treated, for CGT purposes, as being very different.

In other words, HMRC’s position implies a difference of treatment for CGT purposes between somebody acquiring property on the termination of a French usufruct and the termination of the “broadly similar” Scottish liferent’

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3 Although French, German and Luxembourgeois are the three official languages of the Grand Duchy of Luxembourg, the legal documents that created the *Großherzogliches Fideicommis* are in German, and we are therefore using its German title throughout.
4 [2018] UKFTT 217 (TC) (first instance); TC/2017/07299 (on appeal)
5 For more on the differences between English and Scots trust law, see p.5
6 CG3 1305
freedoms under the Treaty on European Union and applied for the matter to be referred to the European Court of Justice (ECJ).

HMRC eventually withdrew its submissions and there was no need for the matter to be referred to the ECJ. Nonetheless, this is a cautionary tale of how a legal system could react very differently to arrangements that produce ‘broadly similar’ effects, but stem from completely different legal environments.

**THE GROßHERZOGLICHES FIDEICOMMIS**

The fidéicommis is rarely used under Luxembourgish law. Article 71 of the Treaty of Vienna of 9 June 1815 established that the Grand Duchy of Luxembourg would become a personal possession of William I of Orange-Nassau, King of the Netherlands, and his successors. The succession rules of the house of Orange-Nassau were set out in the Nassau Family Pact (Nassauischer Erbverein) of 30 June 1783 (the Pact), which essentially provided for the succession of the eldest male descendant in direct or collateral line.

On this basis, when William III died in 1890, leaving as his heir Queen Wilhelmina of the Netherlands, the title of Grand Duke of Luxembourg was bestowed under the Pact, not on Queen Wilhelmina, but on Adolphe of Nassau-Weilburg, whose successors have then continued to rule the diminutive European country.

A Family Constitution (Hausverfassung) was issued on 5 May 1907 (the Constitution) by Grand Duke William IV, who had six daughters but no sons, with a view to allowing his eldest daughter Marie-Adélaide to become Grand Duchess and to have the title pass on to her female successors if she did not have male heirs.

The Pact and the Constitution were amended and restated under two Grand Ducal decrees issued on 11 and 18 June 2012, respectively. One of the most significant amendments was the introduction of complete equality of succession rights between male and female descendants.

The Großherzogliches Fideicommis, or Grand Ducal Estate, was created on 18 April 1868, and comprises the assets that are intended to be passed on from a reigning Grand Duke to his successor, as separate from the private property of the Grand Ducal family. Assets held in the Großherzogliches Fideicommis may not be alienated by the Grand Duke or any other members of his family (in this they are comparable to the Crown Estate in the UK).

On the other hand, the assets forming part of the personal wealth of the Grand Ducal family are governed by the Law of 16 May 1891 on the personal fortune of the Grand Ducal family. These assets may be freely transferred, and conveyances of Luxembourg-situs real estate among members of the Grand Ducal family are exempt from registration and stamp duties.

The Administration des Biens de SAR Le Grand-Duc de Luxembourg (ADB) is an entity that was equally created under the Pact with a view to managing and administering the Großherzogliches Fideicommis. It was joined as a co-defendant to Prince Louis Xavier (the third son of Grand Duke Henri, the current Grand Duke) in the divorce proceedings before the Court.

The ADB may apply funds out of the Großherzogliches Fideicommis to purchase properties outside the Luxembourg borders and allow individual members of the Grand Ducal family to occupy and use them. Such properties belong beneficially to the ADB or the Großherzogliches Fideicommis, even though their legal title may vest in the individual family members occupying and using them. This mechanism is clearly described in the statements made by Albert Wildgen, President of the ADB, to the Court:

‘In such cases, the funds for the purchase (and all costs of purchase) are typically provided by the ADB (from assets belonging to the [Großherzogliches Fideicommis] or from the
‘Undisputed evidence proved that the purchase price for the matrimonial home in London was directly paid by the ADB to the solicitors who dealt with the conveyance’

private funds of HRH the Grand Duke. They are transferred directly to the vendor, and the property is then acquired in the name of the member(s) of the Royal Family. The property may be used by any member of the family. The individuals hold the legal title as nominees and enter into a declaration which generally takes the form of a document known as a “compromis de vente” (sales contract) with the ADB, or unilateral declaration signed by the nominees, in which they confirm that they hold the asset on behalf of the ADB and/or that, on request, they will surrender the asset to the ADB.7

This mechanism was used in relation to the London property occupied as a matrimonial home by Prince Louis Xavier, his wife Tessy and their two children prior to the divorce.

BENEFICIAL OWNERSHIP OF THE MATRIMONIAL HOME

During the case, undisputed evidence proved that the purchase price for Prince Louis Xavier’s and Princess Tessy’s matrimonial home in London was directly paid by the ADB to the solicitors who dealt with the conveyance. Nonetheless, Princess Tessy contended that the property was beneficially owned by her husband and his father on the following grounds:8

‘Within this context the wife nonetheless contended that Prince Louis and his father owned the London property outright as joint tenants. The basis for this contention is the UK Form TR1. On that form, the transferees for entry into the register are listed as the Prince and the Grand Duke, with the address for service listed as the Palais Grand Ducal in Luxembourg. Under the section “Declaration of Trust” on the form, the box stating that the transferees “are to hold the property on trust for themselves as joint tenants”, has been ticked.’

Princess Tessy’s argument was based on a principle stated by Mummery LJ in Pankhania v Chandegra,9 namely that:

‘In the absence of a vitiating factor, such as fraud or mistake, as a ground for setting aside the express trust or as a ground for rectification of it, the court must give legal effect to the express trust declared in the transfer. In the absence of such claims the court cannot go behind that trust.’10

In other words, to the extent that the Prince and his father had held themselves out as ‘joint tenants’ in the declaration of trust included in Form TRI, such declaration should stand and be enforceable.

Nonetheless, the key condition for this argument is that there is no vitiating factor or, following s.53(1) of the England and Wales Law of Property Act 1925: ‘a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing by some person who is able to declare such trust or by his will’.11

In deciding the case, MacDonald J quoted from Lewin on Trusts,12 which provides the following comment:

‘The section requires the declaration of trust to be manifested and proved by “some writing signed by some person who is able to declare such trust...”. The words “who is able to declare such trust” do not necessarily mean the legal owner. Where real property is held on trust it is the owner of the beneficial interest who is able to declare the trust for the purposes of the section and has to sign the memorandum or other writing: the holder of the legal estate is regarded as a mere conduit pipe in this case.’13

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7 Above, note 2, para.11
8 Ibid at para.25
9 [2012] EWCA Civ 1438
10 Ibid at para.65
11 Ibid at para.66, emphasis added in the judgment
12 paras.5-17
13 Ibid at para.67, emphasis added in the judgment
Consequently, a trust of the beneficial interest in the former matrimonial home was not the husband's and the Grand Duke's to declare.\textsuperscript{14} In short, you cannot declare an express trust in a beneficial interest that is not yours (or, to indulge in the Latin, \textit{nemo dat quod non habet}).

To the extent that the matrimonial home was not beneficially owned by the husband, it could not be treated as his ‘resource’ for the purposes of an order under s.25 of the England and Wales Matrimonial Causes Act 1973.

The Princess also mentioned the circumstance that a \textit{compromis de vente}, i.e. a covenant to sell, had been prepared for this property, as was customary practice for all the foreign properties purchased out of the \textit{Großherzogliches Fideicommis} and registered in the name of members of the Luxembourg royal family as nominees. The \textit{compromis de vente} had been signed by the Grand Duke but not by the Prince. This did not change the legal analysis of the beneficial ownership of the property, which the Court viewed was undoubtedly vested in the \textit{Großherzogliches Fideicommis} or in the ADB.

An analysis of the legal nature of these two entities was not conducted in depth. MacDonald J satisfied himself that ‘on the unchallenged expert evidence before the court ... it is more likely than not that the \textit{[Großherzogliches Fideicommis]} and the ADB have separate legal personalities’.\textsuperscript{15}

It is probably incorrect that the \textit{Großherzogliches Fideicommis} may be accurately described as a legal person. Its legal nature is probably closer to that of a trust-like structure: it came into being as a \textit{fidéicommis}, i.e. a civil-law functional equivalent to a trust, before this legal arrangement was repealed or significantly restricted under the \textit{Code Napoléon}, which is today the basis for the Luxembourg \textit{Civil Code}.\textsuperscript{16} (The \textit{fidéicommis} is still commonly used in Dutch law and, indeed, is part of the legal succession rights arrangements between parents and children in the Netherlands. It is also still a feature of German and other civil codes.)

However, for the purposes of this case it was undisputed that, regardless of its legal nature, the \textit{Großherzogliches Fideicommis} or the ADB held the beneficial ownership of the London property in question.

\textbf{TRUSTS, TRUST-LIKE STRUCTURES AND BENEFICIAL OWNERSHIP}

The lack of consistent tax treatment of corporate structures has been well documented. The fact that a corporate structure may be treated as opaque in one jurisdiction but transparent in another has long caused problems of double taxation. The lack of consistent tax treatment of trusts and trust-like structures has been less well publicised. The differing treatment of some trust-like structures for different tax purposes has exacerbated the problems.

Added to this toxic mix are common public misconceptions: that trusts are used by criminals to hide or launder money, or that Her Majesty’s Land Registry records the beneficial ownership of property, rather than merely the registered proprietors.

These issues are now coming to the fore in the EU, with the implementation of the Fifth Anti-Money Laundering Directive (GAMLDD), a subject

\textsuperscript{14} Ibid at para.115
\textsuperscript{15} Ibid at para.113
\textsuperscript{16} The \textit{Code Napoléon} came into force between 1803 and 1804. The territory of present-day Luxembourg was comprised at that time in the French Département des Forêts and the code was promulgated on 5 March 1803.
we have discussed in the Trust Quarterly Review’s sister publication, the STEP Journal.17

Once 5AMLD is brought into effect, by early 2020, art.31 of the Fourth Anti-Money Laundering Directive (4AMLD) will be amended so that:

‘Member States shall ensure that this Article applies to trusts and other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts. Member States shall identify the characteristics to determine where legal arrangements have a structure or functions similar to trusts with regard to such legal arrangements governed under their law.

‘Each Member State shall require that trustees of any express trust administered in that Member State obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust.’

There will no longer be a requirement that the trust be governed by the law of that EU Member State, but that it be administered in that Member State. The drafting is not ideal: it still refers to the obligation to maintain records as applying to ‘any express trust’, but states that the whole article is to apply to trusts and other types of legal arrangements.

The first paragraph of 4AMLD, as amended by 5AMLD,18 obliges Member States to require that the beneficial ownership information of express trusts and similar legal arrangements, as referred to in para.1, be held in a central register set up by the Member State where the trustee of the trust or person holding an equivalent position in a similar legal arrangement is established or resides. It is only if that place is outside the EU that the question of the place of a business relationship, or of the acquisition of real estate, becomes relevant.

Beneficial ownership information must be logged in the central register whether or not the trust generates tax consequences and must be registered in the Member State where the trustee resides.

The question of trust-like structures is of particular interest: ‘trusts and other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts’. Note the use not of ‘and’, but of ‘or’. Some Member States fought hard to insert ‘and’, but lost in the European Parliament. So what legal arrangements have a structure or function ‘similar to trusts’?

A new para.10 requires Member States to:

‘notify to the Commission the categories, description of the characteristics, names and, where applicable, legal basis of the trusts and similar legal arrangements referred to in paragraph 1 by 10 July 2019. The Commission shall publish the consolidated list of such trusts and similar legal arrangements in the Official Journal of the European Union by 10 September 2019’.

Therefore, although the UK courts may regard a Luxembourg fideicommis as a trust-like structure, since it is governed by Luxembourgish law, whether it is to be regarded as a trust-like structure will be a question for Luxembourg, not the UK. Whether Luxembourg will be volunteering to notify that the Großherzogliches Fideicommis discussed in this article has a ‘structure or function similar to trusts’ will be interesting to see. We are very much looking forward to reading the EU Commission list on 10 September 2019.

However, if Luxembourg does not notify that its fideicommis is a trust-like arrangement, does that mean that the UK will not still require that the Luxembourg fideicommis be registered as a trust in the UK if it holds a beneficial interest in immovable property in England and Wales?

The differences between trusts and trust-like structures will continue to produce feast and famine, unfairnesses and opportunities.

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18 art.31-3(a)
DIFC AND ADGM FOUNDATION LAWS

A UAE/US perspective

BY ISMAEL HAJJAR, MIDYA OMAR AND SUZANNE REISMAN

ABSTRACT

• In March 2018, the Dubai International Financial Centre (DIFC) enacted a new foundation law (the DIFC Law) and amended its existing trust law to provide enhanced flexibility for settlors, trustees and beneficiaries in relation to the administration of DIFC trusts. The DIFC’s pronouncements followed the Abu Dhabi Global Market’s (ADGM’s) enactment of regulations permitting the creation of foundations in December 2017 (the ADGM Law).

• The enactment of both laws marked a major turning point for families originating from the Gulf Cooperation Council (GCC) region, who now have a solution to professionalise the ownership of the family wealth located in the region, including shares in family businesses and real estate, in line with global leading practices.

• Many families resident in the GCC have US family members who are subject to worldwide taxation and anti-abuse rules that penalise accumulations of income in foreign structures. The new laws present planning challenges, but will permit many clients to structure their assets so that US family members can benefit in a tax-efficient manner.

1 DIFC Law No. 3 of 2018
2 DIFC Law No. 3 of 2018 and DIFC Law No. 4 of 2018
3 The ADGM Foundation Regulations 2017 (the Trusts (Special Provisions) Regulations that were effective in the ADGM as of 17 April 2016 remain unchanged.

4 The member states of the GCC are the UAE, the Kingdom of Saudi Arabia, the Kingdom of Bahrain, the Sultanate of Oman, Kuwait and Qatar.
The Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM) are financial free zones, and are the only jurisdictions in the UAE where fiduciary vehicles, namely trusts and foundations, can be established. DIFC and ADGM legal entities are relevant in the context of regional wealth preservation because they are generally treated as Gulf Cooperation Council (GCC) legal entities while having their own legal framework based on the common law of England and Wales, and their own independent courts.

GCC families have historically held regional assets through companies, which are more similar to foundations. Indeed, unlike a trust, a foundation has its own legal personality and can hold assets in its own right, so that family members, acting as directors, can retain control over their assets rather than placing them in the custody of a third party (e.g. a trustee). Retaining control is particularly important in the context of ownership in a family business.

Foreign investment restrictions (FIR) applicable in most GCC countries prohibit foreign ownership of specific local assets, such as certain local businesses and real estate.

Legal entities created under the laws of the DIFC and ADGM are generally treated as GCC entities for FIR purposes. The use of a foundation, as opposed to a trust, may simplify enforceability issues, as it is easier to test its compliance with FIR (both the legal entity and its beneficial owners must be tested). An ADGM or DIFC foundation should generally be treated as a GCC-incorporated legal entity in line with other corporate vehicles available in these free zones. The GCC status of the beneficiaries may be substantiated through the inclusion of a specific beneficial entitlement restriction to GCC nationals in the constitutional documents of the foundation. In the context of a DIFC foundation, it may also be achieved through the creation of a register of depositary certificates that can be shared with the relevant authorities in charge of monitoring compliance with FIR.

**PRACTICAL APPLICATIONS OF THE DIFC AND ADGM LAWS**

**OWNERSHIP AND GOVERNANCE OF GCC FAMILY BUSINESSES**

For various reasons, including FIR and, until recently, the absence of strong regional tools to facilitate succession, GCC families have historically owned their local businesses in the personal name of the patriarch, through local sole proprietorships or limited liability companies.

Some families, in an attempt to professionalise the ownership and governance of their businesses, have gone one step further and incorporated a mixed ownership is permitted, it may be possible to use planning techniques employed by non-GCC families, holding up to a certain percentage (e.g. 49 per cent) of a local company in an offshore structure.

5  art.10 (1) DIFC Law, art.3(5) ADGM Law
6  While some local assets can be owned up to a certain percentage (e.g. 49 per cent in the UAE) by foreign nationals, other local assets must be wholly owned by GCC citizens, directly or through a GCC legal structure. It is worth noting that a third category of local assets is exclusively reserved to local citizens (i.e. not to citizens of other GCC countries).
holding company to consolidate all their assets. They would typically have gone through a corporate-, family- and wealth-governance exercise and would have tried to incorporate the outcome of such exercise into the legal documentation of the holding company.

Family constitutions or charters are not legally binding documents, and the enforceability of their provisions has historically been an issue under the laws of GCC countries. This can be attributed to family constitutions not being limited to a set legal requirement of a company or trust law, and rather caters to the specific characteristics of family dynamics and unique interactions between the family and the business and wealth structures.

Moreover, the standard forms of articles of association for onshore companies incorporated in the UAE and other GCC countries are straightforward, which makes it challenging to introduce bespoke provisions, even if they may suit the requirements and interests of a family business and its owners. As such, a foundation governed by the laws of the DIFC or ADGM should permit GCC families to include family governance provisions in their governing documents, therefore turning them into legally enforceable provisions.

GCC FAMILIES HOLDING REAL ESTATE IN THE UAE

DIFC foundations constitute a sustainable option to own real estate located within the Emirate of Dubai, while ADGM foundations provide the same for real estate located within both the Emirates of Abu Dhabi and Dubai.

This has been made possible through the signature by the DIFC and ADGM of several memoranda of understanding (MoUs) with the relevant authorities in charge of real estate registration in the Emirates of Dubai and Abu Dhabi.

It is important to note that real estate subject to FIR could be owned by a DIFC or ADGM foundation only to the extent that the FIR are met at the level of the beneficiaries of such foundation. In other words, real estate assets in the UAE that are subject to FIR may only be held through GCC legal entities (a DIFC or ADGM foundation) if the beneficial owners are GCC citizens.

9 Respectively, the Dubai Land Department and the Abu Dhabi Municipality.

‘Real estate assets in the UAE that are subject to foreign investment restrictions may only be held through GCC legal entities if the beneficial owners are GCC citizens’

SUBSTITUTE TO A WILL FOR NON-MUSLIM EXPATRIATES

As a general rule in the UAE, inheritance matters for Muslims and non-Muslim resident individuals are dealt with in accordance with Shari’a. This means that the estate of a UAE-resident individual is meant to follow Shari’a forced-heirship rules on death. However, non-Muslim expatriates may elect for the law of their country of origin to apply to their will as long as their heirs are neither UAE nationals nor Muslims. Such will should, however, be duly registered with the relevant UAE authorities in order to be valid on death.

The Foundation Laws can be used as a substitute to a will for non-Muslim families who wish to plan their future and allocate their estate on death as per their wishes.

This development is particularly welcomed by owners of assets such as real estate located in the Emirate of Abu Dhabi in the absence of a local equivalent of the DIFC Wills Service Centre.

ECONOMIC SUBSTANCE REQUIREMENTS FOR INTERNATIONAL FAMILIES

The incorporation and management of DIFC and ADGM foundations are not restricted to GCC families. Therefore, international families can also use these vehicles as an alternative to legal entities set up in offshore financial centres.

In the context of rapidly evolving regulations focusing on transparency, compliance and substance, the DIFC and ADGM are well positioned to assist families with the creation of legacy planning structures that adhere to

10 The scope of the DIFC Wills Service Centre is currently limited to assets located within the Emirates of Dubai and Ras Al Khaimah.
economic substance law requirements, as both are practicable locations in which to create local economic substance (i.e. to hold or attend board meetings, or conduct day-to-day management).

At the time of writing, the UAE’s economic substance requirements have not been publicly released. However, Cabinet decision no. 31 of 2019 concerning setting the requirements for economic substance was approved on 30 April 2019.

Before the enactment of such document, there is no requirement to have a local council member or protector. The new cabinet decision is not expected to change this, except if the foundation carries out a relevant activity in the sense of the decision (such activities are in line with the ones included in the relevant economic substance legislations enacted by offshore financial centres).

THE US CONNECTION
Many GCC families have members who are US citizens, green-card holders or otherwise resident in the US for income tax purposes under US domestic law (US Persons).11 US Persons are subject to income tax on their worldwide income and gains and are subject to a variety of anti-abuse rules that require special planning in the context of DIFC and ADGM foundations. A summary of three key issues is included below.

IS THE FOUNDATION A TRUST OR A COMPANY FOR US TAX PURPOSES?
The foundation is a civil-law concept; the US, being a common-law jurisdiction, characterises foundations as either trusts or companies for US tax purposes.

The DIFC Law states that the ‘foundation is a body corporate’ and that the property of a DIFC foundation is not held by it on trust for any other person.12 While the plain language of the DIFC Law clearly indicates that the law is not intended to create a trust, that intent is not dispositive for US tax purposes.

Regulations issued by the US Department of the Treasury13 defining ‘ordinary trusts’ state in part that:

‘generally speaking, an arrangement will be treated as a trust … [for US tax purposes] if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.’14

The regulations also state that trusts are generally governed by the ‘ordinary rules applied in chancery or probate courts’; however, as discussed below, this language is not dispositive of the issue.

The seminal case determining this issue, Estate of Swan v Commissioner,15 determined that, generally, a Liechtenstein foundation (stiftung) will be characterised as a trust for US estate tax purposes.16 In reaching this conclusion, the US Tax Court (the Court) placed significant weight on the fact that the stiftungs in issue were created to hold property for the benefit of the founder’s family and he retained the right to amend or revoke the stiftung during his lifetime.

The Court considered the factors that cause a stiftung to resemble a corporation, including:
• the option of perpetual existence;
• its status as a separate juridical entity; and
• its management by a council, which is analogous to a corporate board of directors, that governs documents that are similar to those of a corporation.

11 The following are considered to be US Persons for tax purposes: an individual who is born in the US; an individual who had at least one parent who was a US citizen who met the requisite US presence requirements as of the date of the individual’s birth; an individual who is naturalised as a US citizen; an individual who is a long-term resident alien or green-card holder who has not made a treaty claim to be treated as a non-resident alien for US income tax purposes; an individual who is taxed as a US resident under the ‘substantial presence’ test based on the individual’s presence in the US during the current year and the two prior years; an individual who has elected to be taxed as a US resident for US tax purposes.

12 art.1 para.2 DIFC Law
14 26 CFR § 301.7701-4(a)
15 247 F. 2d 144 (2d Cir. 1957)
16 The US Internal Revenue Service Chief Counsel’s Office guidance issued in 2009 concluded that, generally, Liechtenstein stiftungs (establishment) will be characterised as corporations because their primary purpose is to actively carry on business activities. Stiftungs must be considered on a case-by-case basis but will generally be characterised as trusts because their primary purpose is to conserve assets rather than to carry on a business. AM 2009-12 (7 October 2009).
Both the DIFC and ADGM foundation share these attributes. Nonetheless, the Court concluded that these were ‘largely the general formal characteristics of a stiftung’. The Court determined that the most significant characteristic was that the stiftung was created to conserve and manage assets for the benefit of the founder’s family.

Both the DIFC Law and the ADGM Law permit the founder to reserve the right to revoke a foundation or to vary or amend its governing documents. While under the DIFC Law a foundation may not be created for a commercial purpose (other than as necessary and ancillary or incidental to its objects), it may issue securities as well as depository receipts. Interests in DIFC foundations are freely transferable, other than as limited by the by-laws. Interests in ADGM foundations, however, are not transferable.

Applying the Court’s analysis to ADGM and DIFC foundations, both entities may be created so that they qualify as trusts for US tax purposes. The creation of an entity that is classified as a trust may be preferable where the family wishes to shelter their assets from US estate tax on the death of a US Person. Indeed, the ability to preserve the family’s legacy for future generations is the primary advantage of the ADGM and DIFC foundations from a US perspective.

THE FOUNDATION AS A FOREIGN GRANTOR TRUST

Both Laws lend themselves to the creation of trusts that will qualify as ‘foreign grantor trusts’ (FGTs) in the event that the founder is not a US Person. The rules for determining FGT status are given under s.672(f)(2)(A) of the US Internal Revenue Code of 1986 (the Code) and state that any portion of trust attributable to assets settled by a non-US Person will be deemed a foreign grantor trust if:

- the settlor has the right to revest the trust assets in the settlor, acting alone or with the consent of a ‘related or subordinate party’ that is ‘subservient’ to the settlor; or
- the only persons who can benefit during the settlor’s lifetime are the settlor and/or the settlor’s spouse.

These provisions also facilitate the step up in basis of a foundation’s assets to fair market value for US tax purposes on the founder’s death. During the founder’s lifetime, any accumulated income and gains will be treated as capital and US Persons who are beneficiaries of the foundation in question (US Beneficiaries) may receive distributions from the foundation free from US income tax.

PLANNING FOR THE DEATH OF A NON-US FOUNDER

In many respects, the issues that must be considered in connection with the death of the founder are no different than those that arise in connection with the death of the settlor of an FGT. The foundation’s assets will need to be analysed to determine whether any of its assets will be characterised as ‘passive foreign investment companies’ or controlled foreign corporations and whether various elections (such as entity elections) need to be made to optimise the position of the US Beneficiaries.

Distributions of accumulated income and gains to US Beneficiaries may be subject to ‘throwback

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17 See ADGM Regulations 9 (governing documents) and 19 (council); and the DIFC Law at art.11 (may be perpetual); art.19 (charter); art.20 (by-laws); and art.22 (council).
18 ADGM Regulation 17(1)(a); DIFC Law art.26
19 Compare Rev. Rul. 2015-14, 2015-26 IRB 1677, A fideicomisco (Mexican Land Trust) is not a trust for US tax purposes, because its only function is to hold land in areas where foreign ownership is restricted; no duty to defend or maintain property.
20 26 CFR § 301.7701-18(b)(2); a marriage entered into outside the US is recognised for federal tax purposes ‘if the relationship would be recognised as a marriage under the laws of at least one state, possession, or territory of the United States, regardless of domicile’. Currently no state, possession or territory of the US recognises marriages to multiple women at the same time.
21 See the Code § 1014.
22 (or Qualified Recipients under the DIFC Law.)
rules’, which tax distributions or accumulated income and gains as ordinary income regardless of their character when earned by the trust. This is disadvantageous in the current environment where ordinary income is taxed at marginal rates of up to 37 per cent, while capital gains are taxed at a rate of 20 per cent. Accumulation distributions are subject to interest charges based on the number of years that the accumulation is deemed to have been held by the trust. The issue may be complicated in this instance due to the limitations imposed by various GCC FIR. If the foundation holds property that cannot be distributed to individuals who are not GCC nationals, it may not be possible to decant income and gains to a US domestic trust. Once again, additional planning will be required to optimise the position of US Beneficiaries.

CONCLUSION

The enactment of the DIFC and ADGM Laws is a significant development. These laws provide valuable tools to regional and international families, allowing them to establish investment and wealth preservation structures that are in line with global leading practices. Such structures allow for the alignment of ownership and family governance and may provide a basis for the legal enforceability of a family constitution, while providing greater protection against the diminution of family wealth held for the benefit of US Beneficiaries.

They are also useful in the context of planning the succession of a regional family who have US family members and provide an alternative to legal entities incorporated in offshore financial centres within a jurisdiction where it is possible to create strong local economic substance.

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24 See the Code § 665-668.
When the authors of *Tristram and Cootes* published the 31st edition in 2015, they commented rather ruefully that the long-awaited revision to the England and Wales *Non-Contentious Probate Rules 1987*, foreshadowed by the review undertaken by Munby LJ in 2009, had still not taken place. Fast-forward to June 2018, when they published the second supplement to this edition, and still the new rules had not been brought into force.

Even so, there is plenty to justify a second supplement. Indeed, one of the reasons the long-awaited revisions may have not yet taken place is the continuation of the pilot scheme for online applications at Oxford District Probate Registry, which is dealt with in the work.

There is really no close rival to *Tristram and Cootes* in terms of non-contentious probate practice. It is the ultimate practitioner’s textbook, being completely clear and practical in nature. Rarely have I used it to research a point and not found the answer. This supplement brings it completely up to date, taking into account, for example, the impact of such legislative changes as the *Marriage (Same Sex Couples) Act 2013* (in terms of marriages taking place in England and Wales and overseas) and case law in respect of execution, such as the Court of Appeal’s recent pronouncement on the meaning of ‘sign’ in *Payne v Payne*.1

In essence, *Tristram and Cootes* guides the probate practitioner through everything from applying for grants and filing the inheritance tax return to dealing with more complex estates, such as those involving a cross-border element.

While it is the pre-eminent resource in respect of non-contentious work, I have always thought that it was a clear, concise (but nevertheless comprehensive) guide to contentious practice. Its summaries of the pleas of lack of capacity, undue influence, want of knowledge and approval, and lack of due execution provide pithy summaries of the law in those areas. I have used the chapter (updated in the second supplement) on the costs in contentious cases in court on more occasions than I can care to remember.

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1 [2018] EWCA Civ 985
This has provided yet another reason why a supplement is needed: the courts have been busy with contentious probate cases. As well as the renaming of the Chancery Division as the Business and Property Court (also helpfully dealt with in the supplement, with the appropriate headings for contentious work), there have been recent cases dealing with capacity, undue influence, want of knowledge and approval, and the standing to bring a probate claim, many of which make an appearance in the supplement.

The book also deals with other aspects of contentious work, such as removal of executors and Inheritance (Provision for Family and Dependants) Act 1975 claims, all of which have generated significant case law in recent years.

Finally, the book and the supplement contain the most useful forms and precedents, thoroughly up to date and, of course, drafted by three authors who have extensive experience of probate practice on the ground.

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