THE AVER ADVISORY

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TRUST PLANNING

EFTA court upholds legitimacy of trusts in European tax planning

Fred. Olsen et al. v. The Norwegian State, EFTA Court (E-3/13 and E-20/13), July 9, 2014

A recent decision from the European Free Trade Association Court has important implications for trust planning within the European Economic Area. The court addressed the use of controlled foreign company tax legislation to look through a trust structure established in a low-tax jurisdiction.

Facts. The Ptarmigan Trust was established in Liechtenstein in 1980 as a discretionary, irrevocable and perpetual trust to hold certain corporate interests of Norway's billionaire Olsen shipping family.

Following the introduction of Norway's CFC rules in 1992, the tax authority claimed that the Ptarmigan Trust was a foreign controlled entity and that its beneficiaries were therefore liable for domestic CFC taxation on their share of profits earned by the trust.

The Olsen family beneficiaries argued that taxation based on the CFC rules violates article 31 of the EEA, which guarantees the freedom of establishment throughout the European Economic Area, as well as article 40 of the EEA, which guarantees the free movement of capital. Consequently, they maintained that they are not subject to Norwegian CFC taxation.

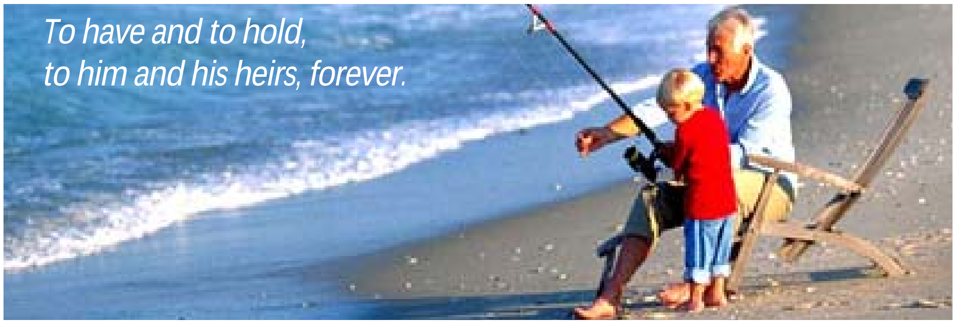
Decision. The court first examined whether a trust qualified as an “establishment” within the scope of article 31 EEA. It found that, provided the trust pursues a real and genuine economic activity within the EEA for an indefinite period and through a fixed place of business, a trust does in fact qualify as an “establishment”.

The court then looked at whether Norway's CFC rules interfere with a taxpayer's freedom of establishment. The court found that the CFC rules create a tax disadvantage for resident taxpayers who are subject to this legislation. In particular, such taxpayers are hindered in exercising their right to freedom of establishment because they are dissuaded from establishing, acquiring or maintaining an undertaking in another EEA state in which they would be subject to low levels of taxation. The court held that this differential treatment constitutes a restriction on the freedom of establishment and amounts to discrimination.

Finally, the court examined whether such a restriction could nonetheless be justified on grounds of overriding public interest, including, for example, to prevent tax avoidance or to maintain the balanced allocation of taxing powers between EEA states.

In this regard, the court stated that a restriction may be proportionate if it relates only to entirely artificial arrangements, which seek to escape the national tax payable in comparable situations. Conversely, the court noted that such a tax measure must not be applied where it is proven that despite the existence of tax motives, a CFC is established in a host EEA state and carries on genuine economic activities, which take effect in the EEA.

Having addressed these preliminary issues, the court ruled in favor of the taxpayer, noting that whether the entity in question conducts a real and genuine economic activity depends on the actual terms of the entity's statutes, such as the trust's deed, and the actual activities of that entity and its management. Provided these conditions are fulfilled, the court stated that neither the income level of the entity, nor the origin of its funds, is relevant. ■



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TRUST PROTECTORS

Guernsey Royal Court confirms removal of trust protector to preserve welfare of beneficiaries

In the Matter of the K Trust, Royal Court of Guernsey, Guernsey Judgment 31/2015, July 14, 2015

In sanctioning, for the first time, the removal of a trust protector in Guernsey, the Royal Court of Guernsey held that a protector may be removed from office when necessary to prevent an adverse impact on the welfare of the beneficiaries and the competent administration of the trust.

The court applied the rule established in Jersey case law.

Facts. The K Trust was settled in 1990. The protector was a financial advisor and became a close friend of the settlor during her office as protector of the trust. In 2001, at the time of the settlor's death, his widow was the only beneficiary of the trust. The widow added 13 beneficiaries from 2003 onwards, including the protector and some of the widow's nieces and nephews.

Relations between the protector and the widow were initially cordial. Following the settlor's death, however, the widow formally requested the protector to step down. This request was made on numerous occasions and was repeatedly rejected. The protector considered that she was privy to the settlor's wishes and best placed to put them into effect.

The widow ceased attending trustee meetings on the basis that she felt marginalised. Subsequently, the widow and three other beneficiaries requested the trustee take steps to terminate the trust. The protector was not supportive and considered that the K Trust needed to continue to hold assets as a contingency against future liabilities.

All of the adult beneficiaries made a formal and final request that the protector retire. The protector, however, stood firm. Accordingly, 11 of the 14 adult beneficiaries of the K Trust issued an application seeking the removal of the protector.

Decision. The Guernsey court agreed with the trustee's assessment that there had been a breakdown in the relationship between the beneficiaries and the protector, with the result that the trust had become unworkable.

The court rejected the argument that a protector should only be removed in exceptional circumstances. What mattered most, the court held, were the welfare of the beneficiaries and the competent administration of the trust in their favor. Accordingly, the court granted the removal application. ■

TAX TREATIES

Monaco SCI confirmed as efficient tax planning tool for holding French real estate

In re Jean Y, Decision No. 622 (Appeal No. 14-14256), Cour de cassation, October 2, 2015

The French Cour de Cassation recently confirmed that French real estate owned by a Moroccan citizen tax resident of Monaco through a Monaco SCI—société civile immobilière—is not liable to French inheritance tax but exclusively to Monegasque inheritance tax.

Background. French tax authorities have traditionally not recognized the shares of a Monegasque SCI as movable assets governed by article 6 of the *France-Monaco Double Tax Treaty* signed on April 1, 1950. Instead, France treated these shares as immovable assets governed by article 2 of the treaty, which allows France to levy inheritance tax.

In 2011, the French courts held that shares in a Monegasque SCI can be movable assets subject to the exclusive inheritance tax competence of Monaco. In a 2012 decision, the French Cour de cassation held all shares of a Monegasque SCI subject to French inheritance tax.

In 2014, the Cour de cassation reversed its position. It is this principle that the court has now confirmed with its October 2015 decision.

Facts. Jean Y. was a Moroccan national, who resided in Monaco and died in France in April 2000. His successors were his brother, his sister and eleven nieces and nephews. The deceased owned French real estate through a Monegasque SCI.

The French tax administration treated the SCI shares as immoveable assets and included them among the deceased's taxable estate assets in France. The heirs argued against such inclusion and sought a tax refund.

Decision. The court held that the shares of the Monaco SCI are movable assets subject to article 6 of the treaty. Consequently, such assets are not liable to French inheritance tax, but exclusively to Monegasque inheritance tax.

Comments. Some important conclusions to be drawn from this French Supreme Court decision include:

- Shares of Monegasque SCIs can be movable assets for inheritance tax matters.
- Such shares transferred by death of a Monaco tax resident are not subject to French inheritance tax, but rather Monegasque inheritance tax (none between spouses and in direct line, and a maximum of 16% between non-relatives).
- The absence of the right to levy French inheritance tax on such shares applies regardless of whether French tax resident heirs exist.
- Non-French and non-Monegasque citizens may benefit from the provisions of the treaty. ■

ASSET PROTECTION TRUSTS

US court finds divorce arranged to fraudulently transfer assets

US v. Baker, 2015 WL 4886081, US District Court, District of Massachusetts, Aug. 17, 2015

A recent US case concerned the fraudulent transfer of two properties into trust and the arrangement of a divorce in order to shelter assets from creditors. A phony divorce can make things worse, rather than better. The decision is a reminder that substance prevails over form, definitely so in asset protection planning.

Facts. Scott and Robin Baker married in 1998 and had two children. At that time, Scott and his business partner were running numerous Planet Fitness gyms. In 2001, the Baker's faced taxable income of over $1.1 million, which they attempted to mitigate by using a tax shelter marketed by KPMG (later determined to be abusive).

In 2002, the partners sold eight Planet Fitness gyms to Bally Fitness, for which Scott ultimately received $3.4 million. Scott used the tax shelter to reduce his earnings and then offset his income for 2002 against previous years' losses. He then claimed a refund from the IRS for nearly the entire amount of tax paid. In 2005, the IRS opened an examination of Scott Baker's 2002 income tax returns.

In 2007, the Bakers established two trusts, one into which they transferred title to their family home. To the other trust, they transferred their vacation home.

The Bakers claimed that these transfers were made to make it easier to deal with the property in case they later divorced, and because they were concerned that Scott Baker might have creditors from his new construction business.

In 2008, the Bakers filed for divorce citing irreconcilable differences. Their divorce was confirmed by a 2008 state court judgment. The separation agreement gave sole ownership of the homes to Robin Baker, though noting that it was held in trust for the benefit of their children.

Although divorced, evidence showed the Bakers continued to live and take vacations together, and held themselves out as husband and wife in all ways.

Scott testified that he never told his teenage children that he and Robin divorced, and that he did not know if his children knew of the separation.

The US government sued the Bakers for fraudulent transfers, and sought to have the existing tax claims against Scott Baker enforced against the real estate assets.

Decision. The court noted that the acceptance of a separation agreement by a judge in a divorce proceeding as fair among the two parties does not represent a determination that the agreement perpetrates no fraud upon the creditors of one spouse, particularly where the claims of creditors are not made known to the court.

While the court did not declare the divorce itself to be invalid, it did hold that the property transferred in the divorce constituted fraudulent transfers. Consequently, the court decided in favor of the US government on its fraudulent transfer claims. ■

INFORMATION SHARING

British overseas territories resist UK demands for public company registries

The British overseas territories, including the Cayman Islands, Bermuda and the British Virgin Islands, have scored a victory against being forced to implement a public registry of beneficial owners.

The UK Government sought open access—directly accessible by the UK authorities—to the names of owners of companies registered in its overseas territories.

The EU's fourth *Anti-Money Laundering Directive* was passed in May 2015 requiring central registers of beneficial ownership information. Such information was to be made accessible by law enforcement authorities, concerned entities, and members of the public who could demonstrate a legitimate interest in the information.

In December 2015, the UK announced that the territories had committed to holding beneficial ownership information "via central registers or similarly effective systems". It was pointed out, however, that such information will not be made accessible to the general public.

The ministers discussed details of how these systems should be implemented, including through technical dialogue between the overseas territories and UK law enforcement authorities "on further developing a timely, safe and secure information exchange process to increase the collective effectiveness for the purposes of law enforcement."

Cayman Islands premier Alden McLaughlin confirmed that "there is agreement to hold beneficial ownership information in central registries or similarly effective mechanisms, but there is no agreement to public registries and there is no agreement to direct access to information by foreign law enforcement, tax or regulatory authorities." ■