THE AVER ADVISORY

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presented by Aver Associates Estate Planners & Trustees contact@averassociates.com

IN THIS ISSUE .....

TAXATION
German anti-avoidance rule found to infringe EU law
In re: Deister Holding AG (C-504/16) and Juhler Holding A/S (C-613/16), Court of Justice of the European Union, December 21, 2017

PRIVACY
Latest EU directive rejects public transparency for trusts
Agreement between EU Council and European Parliament regarding 5th Anti-Money Laundering Directive, December 15, 2017

TRUST MIGRATION
Exit tax on trust migration found to be incompatible with freedom of establishment
Trustees of the P Panayi Accumulation & Maintenance Settlements v. UK, C-646/15 (CJEU 2016), Court of Justice of the European Union

TRUSTEE DISCRETION
Court approves trustee decision to withhold trust size information from young adult beneficiary
In the Matter of the C Settlement, [2017] JRC 035A (Jersey Royal Court)

ESTATE PRESERVATION
Expats prevail in real estate investment court battles with banks
In re: Sabadell Solbank, First Instance Court No. 8 of Marbella, Spain, December 19, 2017

In re: Sparkasse Bank Slovenia, Higher Court Ljubljana, January 18, 2018

CELEBRITY ESTATES
Hefner trust deed includes strict requirements against substance abuse

ESTATE PLANNING
Court finds Husband's refusal to permit wife to remarry religiously warrants disproportionate asset distribution
Sharabani v. Sharabani, 2017-06857, Index No. 54890/10, New York Supreme Court, July 26, 2017

TAXATION

German anti-avoidance rule found to infringe EU law

In re: Deister Holding AG (C-504/16) and Juhler Holding A/S (C-613/16), Court of Justice of the European Union, December 21, 2017

The Court of Justice of the European Union recently considered two cases in which foreign parent companies received dividends from a German subsidiary on which withholding tax was levied. Their foreign parent company claims for withholding tax relief were denied by tax authorities based on application of abuse presumptions in German tax law.

Background. Foreign companies that invest in Germany through a German corporation and receive dividends must satisfy an anti-avoidance rule to benefit from a withholding tax exemption.

An exemption is denied where the shareholders of the foreign company would not be entitled to the exemption, if they had received the dividends directly, and the foreign parent company fails to satisfy an economic purpose test.

Facts. The claimants received dividends from a German GmbH and sought withholding tax relief pursuant to the *EU Parent-Subsidiary Directive* (PSD). The requests were refused by the German tax authority. The claimants argued that Germany's anti-avoidance rule was incompatible with both the EU freedom of establishment principle, as well as the PSD.

Decision. The court found that the German anti-avoidance rule infringes on both the freedom of establishment principle, as well as the PSD. The court held that such infringement can only be justified if its specific objective is to prevent conduct involving the creation of wholly-artificial arrangements; that is, structures which do not reflect economic reality, and whose purpose is to unduly obtain a tax advantage.

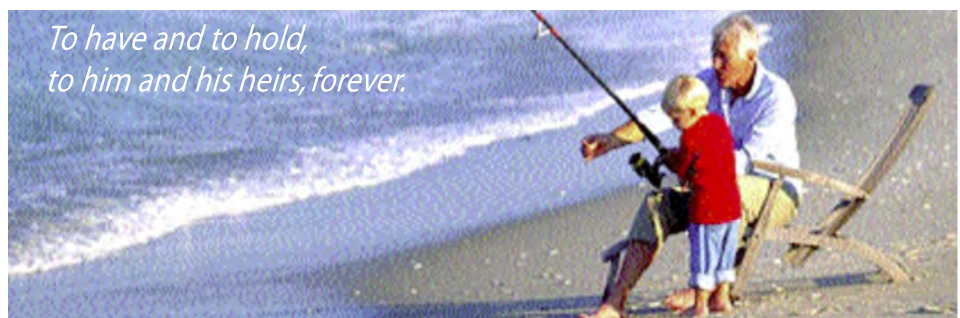
In addition, the court established guidelines for application of domestic anti-avoidance rules, which contain a presumption of fraud or abuse. Tax authorities may not confine themselves to applying pre-determined general criteria, but rather must carry out a case-by-case analysis based on factors including:

i) The organizational, economic or other substantial features of the group.
ii) The structures and strategies of the entire operation.

Comments. In the context of this decision, it is noteworthy that, as of 2018, the Netherlands has introduced new substance rules for foreign intermediate holding companies in order to access the zero Dutch dividend withholding tax rate. The substance requirements include qualified staff, wage costs of at least EUR 100,000, an office lease (long-term) and the following:

i) At least half of the board members with the power to make decisions must be resident in the country where the entity is resident (the residence country);
ii) Board decisions must be made in the residence country;
iii) The most important bank accounts must to be held in the residence country;
iv) Bookkeeping is to be done in the residence country.

If, based on these substance provisions, the dividend withholding tax exemption is not applicable, then the provisions of an applicable tax treaty still need to be followed. ■



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PRIVACY

Latest EU directive rejects public transparency for trusts

Agreement between EU Council and European Parliament regarding 5th Anti-Money Laundering Directive, December 15, 2017

On December 20, 2017, EU ambassadors confirmed that an agreement had been reached regarding the latest amendments to the *European Union Anti-Money Laundering Directive*. The 5th AMLD acknowledges the privacy of trusts as an important and legitimate tool in estate planning.

As part of its action plan for strengthening the fight against terrorist financing, and in reaction to the Panama Papers revelations of April 2016, the European Commission proposed rules to increase transparency by granting public access to beneficial ownership registers of companies and trusts.

However, certain EU member states—Luxembourg, Malta, Cyprus, Ireland, and the United Kingdom—refused to give in to the demand for full public transparency of all trusts, regardless of their purpose.

The new directive recognizes that trusts may also be set up for non-commercial purposes, including charitable aims, administration of family assets, and purposes beneficial to the community.

Data on the beneficial owners of such trusts will only be granted to persons holding a legitimate interest.

In addition, access will be granted upon written request, in cases where the trust owns a company that is not incorporated in the EU.

Note that not all trusts are targeted. Only trusts that generate tax consequences end up in the register.

If a Maltese trust has not incurred any liability to pay taxes in Malta, the beneficial ownership information of such a trust need not be included in the Maltese Register of Beneficial Owners of Trusts. ■

TRUST MIGRATION

Exit tax on trust migration found to be incompatible with freedom of establishment

Trustees of the P Panayi Accumulation & Maintenance Settlements v. UK, C-646/15 (CJEU 2016), Court of Justice of the European Union

Facts. Four trusts were created in 1992 by Panico Panayi, a Cypriot national, for the benefit of his children and other family members. When the trusts were created, Panayi, his wife and their children resided in the UK. The initial trustees were Panayi and a UK corporate trustee. Mrs. Panayi was added as a trustee in 2003.

In 2004, the couple returned to Cyprus permanently. Before leaving the UK, they both resigned as trustees and Panayi appointed three new trustees, all resident in Cyprus.

The UK tax authority took the position that the trust migration—resulting from trustees ceasing to be UK resident—is a deemed disposition for capital gains tax purposes. The case was referred to the Court of Justice of the European Union for a preliminary ruling on whether the exit charge on trust migration is compatible with the freedom of establishment principle.

Decision. The CJEU was charged with finding a balance between the principle of proportionality; that is, the equitable allocation of taxation powers of member states, on the one hand, and the principles of freedom of establishment, freedom to provide services and free movement of capital, on the other hand.

The court found that the UK exit tax, which requires immediate payment of the tax due, discourages trustees from transferring the place of management of the trust to another member state. It also restrains the settlor from appointing new non-resident trustees.

The court noted that legislation which allows the taxpayer to choose between immediate or deferred payment of tax, together with interest, if appropriate, would constitute a measure less harmful to freedom of establishment. As such, the UK legislation goes beyond what is necessary to achieve the objective of preserving the allocation of taxation powers between member states. Consequently, the court held that the UK exit tax constitutes an unjustified restriction on the freedom of establishment. ■

TRUSTEE DISCRETION

Court approves trustee decision to withhold trust size information from young adult beneficiary

In the Matter of the C Settlement, [2017] JRC 035A (Jersey Royal Court)

Facts. Mr. K, 19 years old, was one of three beneficiaries of a family trust worth £75 million. The trustee sought consent from two of the three beneficiaries to sign a settlement agreement affecting the trust. The trustee declined to seek consent from K on the basis that to learn of the trust's size at this time was not in K's best interests.

Decision. The court noted that, as a principal beneficiary under the trust and being of full age, K would generally be entitled to full details about the trust. The court also stated that a trustee had discretion not to inform a beneficiary of their entitlement where they could justify their decision on the basis of the beneficiary's age, character or "some other special reason".

In this case, the court found that knowledge of the trust could upset the balance in K's life at a time when he was still maturing. Knowledge of the size of the trust, the court said, might discourage K from completing tertiary education or obtaining reasonable employment and instead drive him towards a dissolute lifestyle of "party-going or riotous living". The court stated that the exercise of what it termed a "paternalistic approach" is dependent on the facts of each case. ■

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ESTATE PRESERVATION

Expats prevail in real estate investment court battles with banks

In re: Sabadell Solbank, First Instance Court No. 8 of Marbella, Malaga, Spain, Dec. 19, 2017

In re: Sparkasse Bank Slovenia, Higher Court Ljubljana, January 18, 2018

A Spanish financial institution, Sabadell Solbank, has been ordered to pay damages to expats over a failed real estate development project. A Mallorca court ruled in favour of expats who had invested in the Cala Romantica development in 2006.

The claimants requested the return of their advance payments due to a lack of construction. The project was scheduled for completion in 2008, but was cancelled in 2011 following bankruptcy of the developer. The investors sued Solbank in its capacity as guarantor of the developer.

Solbank argued that it had no legal relationship with the claimants as it was not involved in any of the purchase contracts.

The court found that the responsibility of Solbank towards the individual investors derives from *Law 57/1968* and the issuance of a guarantee signed between the developer and Solbank, despite the fact that the buyers did not have individual guarantees.

In January 2018, a court in Slovenia annulled a real estate loan denominated in Swiss francs on grounds that the borrower was not informed of the high currency risk related to the Swiss franc.

Between 2004 and 2008, many borrowers in Slovenia—and elsewhere in Europe—took out loans denominated in Swiss francs in order to benefit from low Swiss interest rates. However, their repayment obligations soared when Switzerland scrapped its cap on the currency in January 2015.

The court held Sparkasse Bank liable for not informing the borrower of the currency risks while they expected to profit on that account. Accordingly, the borrower was required to repay only the loan amount without interest. ■

CELEBRITY ESTATES

Hefner trust deed includes strict requirements against substance abuse

Despite hosting grand parties with many celebrities at the Playboy Mansion, Hugh Hefner was always fearful of the destructive effect that drugs and alcohol could have on a person's well-being.

The late Playboy founder, who passed away in September 2017 at age 91, settled a trust in 1991 for his beneficiaries—third wife Crystal Harris, daughter Christie and sons David, Marston and Cooper.

In December 2017, thanks to a petition filed in Los Angeles by the trustee, it was revealed that Hefner included a clause in his trust blocking any beneficiary from access to his fortune if they abuse drugs or alcohol.

The trust provides that "if the trustees reasonably believe that a beneficiary routinely or frequently uses or consumes any illegal substance so as to be physically or psychologically dependent upon that substance, or is clinically dependent upon the use or consumption of alcohol or any other legal drug or chemical substance that is not prescribed by a board certified medical doctor or psychiatrist in a current program of treatment supervised by such doctor or psychiatrist," then any distributions to the beneficiary will be suspended.

The media mogul also excluded from his inheritance any posthumously conceived children. The trust provisions state that "any person who claims to be a child of mine, including any child of mine conceived after my death, unless such child lived with me in my household and was acknowledged by me in writing to be my child", shall be excluded from receiving any distributions from the trust.

While clearly setting strict lifestyle standards for his beneficiaries, it is apparent that Hefner was a person who also believed in second chances. According to terms of the trust deed, should any of Hefner's beneficiaries encounter substance abuse problems, they may use trust funds to attend a treatment program. The beneficiaries can have their distributions reinstated if they are clean and sober for a year, and are able to care for themselves. ■

ESTATE PLANNING

Court finds Husband's refusal to permit wife to remarry religiously warrants disproportionate asset distribution

Sharabani v. Sharabani, 2017-06857, Index No. 54890/10, New York Supreme Court, July 26, 2017

Estate planners are often required to address the interplay between trusts, estates and matrimonial practices. A recent decision in New York addressed the implications of a husband's refusal to grant his wife a religious divorce—a so-called Get under Jewish law.

A Get must be given voluntarily by a husband to a wife in order for her to remarry in the Jewish faith and in order for her children of that subsequent marriage to be recognized as Jewish. Without the Get, in an observant community, the woman is a pariah.

Facts. The parties were married in 2006 by Israeli religious tradition. The wife filed for divorce in 2010 requesting, *inter alia*, equitable distribution of the marital assets, which included a rental property in Israel. The husband contested the divorce and refused to grant a Get to his wife. A special referee determined the husband's refusal to be cruel and inhumane.

Decision. The court ordered that the property should be sold and the net proceeds divided equally, conditional upon the wife receiving a Get within 30 days, failing which the wife would receive 100% of the proceeds from the sale of these assets.

The court also found the husband had limited job prospects, which further justified the disproportionate marital asset distribution. ■