Koele
Tax & Legal Perspecta

Attorney at law and Tax Lawyer
Advocaat en belastingadviseur

Netherlands

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Ineke A. Koele
Koele Tax & Legal Perspecta
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Introduction

Based in the heart of continental Europe, with a North European culture and a long tradition of trademanship, the legal culture is quite different from the Anglo-Saxon legal culture. Randomly, I mention some key features:
As we are part of the civil law jurisdictions with a Napoleontic code, we have no probate procedures but instead the French 'saisine'. Dutch law knows forced heirship for children, but in practice the effects can be marginalized and no clawback is foreseen for gifts longer than 5 years before the decease of the testator. We do believe in inheritance and gift taxes and have robust tax legislation in place with rates varying up to 20% (direct descendants) or to 40% (other relationships) that applies to Dutch resident donors or testators with only rather moderate exemptions. Where Dutch citizens migrate to other jurisdictions, they will be continuously subject to Dutch gift and inheritance tax for a period of 10 years no matter who and where the recipients will be. There are no general exempt devices such as life insurance wrappers or other 'standard' havens. Notaries have a strong formal power and do e.g. qualify as the 'competent authority' in the European Succession Regulation, which is not always easy to reconcile with their client relationship. Also, notaries have a predominant power in determining and providing proof of capacity which is increasingly becoming problematic with a population that is getting older and suffering of different kinds of dementia that not always are being recognized by notaries (with no knowledge whatsoever of mental physics).

One of the most salient features, however, of Dutch international estate planning is the Dutch attitude towards foreign discretionary trusts and similar 'purpose funds' including foundations. This frequently causes unexpected issues.

The Hague Convention : recognition of trusts for legal purposes

The Netherlands is a contracting party to ***The Hague Convention on the law applicable to trusts and on their recognition***, that is in effect since 1996. This treaty provides for recognition of trusts settled according to the law of a jurisdiction that has trust law and the significant elements of the trust (except for the choice of law, the place of administration and the habitual residence of the trustee) are not more closely connected with

states which do not have the institution of the trust or the category of trust involved (article 13 The Hague convention). If there is nexus with the law according to which the trust has been settled and the trust would be recognized according to Dutch international private law.

The recognition is not absolute. Article 15 of the Convention stipulates that the convention does not prevent the application of provisions of the law designated by the conflict rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, relating in particular to the following matters:

a) The protection of minors and incapable parties;

b) The personal and proprietary effects of marriage;

c) Succession rights, teste and intestate, especially the indefeasible shares of spouses and relatives;

d) The transfer of title to property and security interests in property;

e) The protection of creditors in matters of insolvency;

f) The protection, in other respects, of third parties acting in good faith.

If recognition of a trust is prevented by application of the preceding paragraph, the court shall try to give effect to the object of the trust by other means.
And last not but not least, the Hague convention on trusts does not apply to tax issues and accordingly does not prejudice the power of States in fiscal matters (article 19).

Dutch taxation with respect to trust settlements and similar 'purpose funds'

Whilst before 2010 no specific tax legislation relating to trusts existed in the Netherlands and trust settlements were 'interpreted' for Dutch tax purposes on a case by case basis, as of 2010 the Netherlands introduced the 'APV' regime based on the underlying principle, that 'sheltering of assets' between persons is not accepted for Dutch tax purposes. The intention was that all trust assets that could not be taxed directly in the hands of a beneficiary or a settlor already, should be attributed to the settlor / transferor of assets or if this person would not be alive at some points, to the (deemed) beneficiaries for tax purposes.

There are a couple of issues with this new APV regime, which can be summarized as follows:

a. What means 'discretionary'?

The APV regime only applies to 'discretionary held' assets within a purpose fund such as a trust, foundation, Anstalt or other legal form – the qualification as to whether assets are held on a discretionary basis however is to be interpreted according to Dutch tax law. This refers to assets that are not subject to any 'legally enforceable claim' which is a

rather unsophisticated reference in the context of Anglo-Saxon trust law. A beneficiary with a legally enforceable entitlement vis à vis a trust will be subjected to tax to this extent without the interference of the APV regime. Accordingly, this may lead to complex litigation with rather unpredictable outcomes[1]. Where a legally enforceable entitlement will be recognized as a direct entitlement (without application of the attribution rules), the Supreme Court has considered the discretionary elements in a New York Trust in its 2015 decision as irrelevant based on the notion, that the trust served only one (potential) beneficiary (and in case of decease, further descendants of this beneficiary). The fact that the trustee only has the discretionary power for the benefit of one specified beneficiary, was in this case considered crucial. We have to be cautious in taking conclusions from a Supreme Court decision in another factual situation[2], as another approach can be found in the decision of the Court of the Hague of 28 May 2019. The Court dealt with a a resident of the US, bequeathing her assets to each of her three children by Will, one of whom is a resident of the Netherlands. With respect to the latter, she indicated that the assets should be held discretionary in trust for the benefit of her Dutch resident daughter, with '*the power to distribute as much of the net income and the principal as the trustee may from time to time think desirable for the health support or education of the daughter or any of her descendants. Any net income not so applied shall from time to time be accumulated and added to the principal.* '
At the daughter's death, any then remaining principal shall be paid to or in trust for such descendants as she may appoint by will, or if she did not make use of this power of appointment, to her descendants, or to my then-living descendants etc.

The Court held that the trustee held full discretion to manage the trust. The beneficiary does not have any concrete and enforceable right to a distribution. Accordingly, the attribution rules of Article 2.14a of the Income Tax Act apply to the entire assets in the trust.

b. Deemed attribution

To the extent the trust is discretionary in character in the above-mentioned context, the APV regime would attribute the assets and income of the trust to the respective transferors of the assets. Upon their decease, the assets and income of the trust are *deemed to be* attributed for tax purposes to the respective heirs of the same. The question therefore is paramount as to whom would be considered the heirs and in what proportions of the estate according to applicable international private estate law, and irrespective as to whether the assets held in trust would be subject of the estate according to the applicable (foreign) estate law. For the purpose of this fictitious attribution to heirs, a heir that is

[1] Such as the Supreme Court 10 April 2015, ECLI:NL:HR:2015:849.
[2] A critical analysis has been published by I.A. Koele, The scope of the APV regime – the mystery resolved?, in Vakblad Estate Planning, 2015-33. My analysis held that the Supreme Court issued this decision with a certain purpose. That makes it absolutely unclear whether the same reasoning would be upheld in another factual pattern.

(partly[3]) disinherited but at the same time, is a direct or indirect beneficiary of the APV, is deemed to inherit for the purpose of this fictitious attribution rule[4].

The deemed attribution can only be avoided if the heir is able to demonstrate that he or she is not a beneficiary of the APV and is not able to become a beneficiary in the future, *i.e.* is irrevocably appointed as 'Excluded Person'[5], referred to as the 'rebuttal rule'.
The deemed attribution of assets and income leads to unanticipated effects since it is irrelevant for Dutch tax purposes whether the 'heir' who is a resident of the Netherlands is indeed about to receive distributions of the trust or not. Income tax is based on a fictitious yield generated by the assets allocated to the respective 'heirs'[6]. That would mean, that even if all income of an existing trust will ongoing be distributed to the spouse (who is not a heir), a Dutch resident heir would have to pay income tax with respect to an attributed portion of assets[7].

The rather literal application of the APV regime also has positive unanticipated effects. In the judgment of the Court of Appeal of The Hague referred to above, despite the intention of the testator to allocate assets for the benefit of one Dutch resident child, only one third of the assets of a trust were attributed to this child residing in the Netherlands. There were three heirs, but only with regard to the heir residing in the Netherlands was a trust formed. In theory, the other two heirs could inherit on the death of the Dutch heir, but only if her children were pre-deceased.

In this case, the outcome is unreasonable but favorable. Although the assets in trust are held entirely for the primary benefit of the Dutch resident daughter, only 1/3 of these assets were attributed to her for tax purposes. If there would have been similar trusts settled for her siblings, also 1/3 of these assets would be attributed to her which provided a more reasonable outcome. The tax inspector tried to reverse this result by appealing to the rebuttal rule of Article 2.14a(6) of the Income Tax Act. Albeit this rebuttal rule was introduced to protect the taxpayer, it was decided that the tax authorities could also appeal to this rule. However, it did not help the tax inspector as it was decided that the siblings could potentially benefit from the trust assets upon decease of the daughter and therefore, the rebuttal rule (that should be interpreted strictly) did not change the outcome that effectively 2/3 of the assets remained outside

[3] It has been in added in Parliamentary History, that distinctive provisions in Wills should be read in conjunction with the trust clauses as towards the rights of the same person as a beneficiary under an APV; the provision is intended to function as a broad anti-abuse provision.

[4] Article 2.14a § 4 Income Tax Act 2001.

[5] Article 2.14a § 6 Income Tax Act 2001.

[6] The Dutch tax rules, based on transparency of trust assets, is considered in contradiction with the 'due process clause' under the 14th amendment as recently decided by the Supreme Court in the Kaestner case. That obviously will not alter the position under Dutch tax.

[7] In specific situations, an analogy may be applied with the exemption of at least income tax that applies to heirs that have received the 'bare ownership' of assets whilst the surviving spouse has the usufruct during his/her life.

the scope of the Dutch tax system.
This is also a logical consequence of the APV regulations.

c. **Consequences of attribution of assets**

The consequence of the allocation of assets and income is laid down by law as a fiction. In many respects it is not yet clear whether this fiction also has an impact on other schemes.

For example, to the extent that trust capital consists of substantial interests in companies, the question will be what the acquisition price will be that will be 'inherited' with respect to these shares via the fiction of Section 2.14a of the Income Tax Act. If a Dutch resident directly inherits an interest in a foreign company, a step-up will be granted for the value of the shares at the time of inheritance. The question is whether the same applies via the fiction of the attribution. If the trust has claims on the same company, a commercial interest is attributable to the Dutch heir for his share in it, which will be taxed progressively. If no (business) interest is charged, a fictitious interest must be corrected. In practice, stacking fictions can lead to difficult situations.

As the APV legislation has not been restricted in time and does not contain general grandfathering provisions for existing structures at the time of enforcement, it may be questioned whether the deemed attribution of assets should also be viewed from the perspective of past generations. The attitude of the Dutch tax authorities is that unrestrictedly, we have to view the past inheritances and (deemed) inheritances in order to assess the consequences for the present generations. Here it appears relevant and not yet crystallized at all, that for the purpose of the fictitious attribution of assets and income of an APV to heirs, a heir that is disinherited but at the same time, is a direct or indirect beneficiary of the APV, is *deemed to inherit* for the purpose of this fictitious attribution rule, according to the exception formulated in article 2.14a paragraph 4 Income Tax Act. In the opinion of the Dutch tax authorities, this deemed inheritance can also take place in the past – long before the APV regime was enforced -, even without the need of any abusive structure and even in cases where only an indirect inheritance [8]can be identified, which altogether may result in unanticipated consequences.

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[8] According to Dutch estate law there is a substantial difference between a direct disinheritance ('*I disinherit my children*') or an indirect disinheritance ('*I appoint Gabriela as my heir",* only indirectly disinheriting my children). If indirectly disinherited heirs would be deemed to be heirs for the purpose of the APV legislation, this would entail serious overkill. This applies all the more because paragraph 6, last sentence, of Article 2.14a of the Wet IB 2001 also offers sufficient protection against abuse, since it stipulates that t*he attribution under the main rule of the APV regime does not apply if it appears that the succession by virtue of a disposition of property upon death is predominantly aimed at avoiding or delaying the said attribution in whole or in part*.

In practice, a proactive approach towards the tax authorities can lead to reasonable results, so that the irregularities in the APV legislation can most often be ironed out. In some cases, however, principled litigation is required to create clarity and certainty about the qualification of the trust.

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