The Aver Advisory

MAY 2015

presented by Aver Associates Estate Planners & Trustees

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Liechtenstein Foundations

Tax authority confirms equal treatment of Liechtenstein and Belgian foundations

Belgian Ruling Commission, Nos. 2014.644 (16/12/2014) and No. 2014.543 (9/12/2014)

Two recent decisions of the Belgian Ruling Commission provide new guidance on the use of foreign private foundations in Belgian (Flemish) estate planning. As Liechtenstein is a member of the EEA, the commission held that a Liechtenstein foundation qualifies as a private foundation under Belgian tax laws similar to a Belgian foundation.

Certain reduced rates of inheritance and gift taxes, which are applicable to a Belgian private foundation, now also apply to a Liechtenstein foundation; for example, registered transfers and donations to a private foundation benefit from a reduced tax rate of 5.5%. In cases where the donation concerns a family business, the tax rate is 0%.

Non-registered transfers are exposed to inheritance tax when the donor dies within three years, or seven years for a family business. In such cases, the reduced tax rate of 8.5%, or 7% for family businesses, applies.

The commission also noted that the private foundation must be duly constituted, failing which the private foundation may be declared a "sham foundation" and be subject to normal inheritance tax rules. The validity of a foundation depends largely on the independence of the foundation managers, who must be entirely free to dispose of the assets of the foundation. This will generally be the case, for example, where:

- The founder neither retains control, nor any ownership rights;
- The entitlement to the benefit of the foundation is with determined or determinable beneficiaries;
- The foundation board decides on distributions;
- The foundation board is independent;
- Beneficiaries have neither influence, nor a special status;
- Termination of the foundation council is not possible at will of the founder. ■

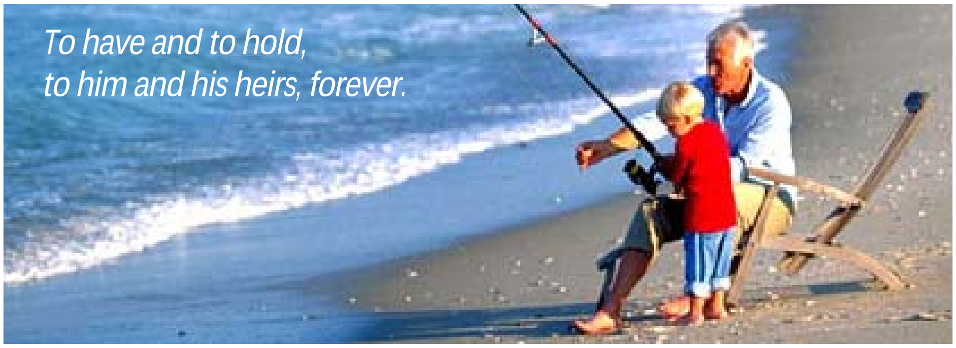
Liechtenstein sham foundation

Austrian Supreme Administrative Court, No. 2011/13/0003, February 25, 2015

Facts. A Liechtenstein foundation was established in 1963 by an Austrian-resident founder. A mandate agreement was signed between the founder and the board of directors of the foundation. The agreement provided that the board of directors may only act independently to the extent that the founder did not give instructions. It was established that the founder did not actually exercise his right to influence the management of the foundation. As such, it was argued that the income of the foundation was not attributable to the founder personally, but rather to the foundation.

Decision. In its judgment, the court found that the income was indeed attributable to the individual. It was held that income is generally attributable to the person who controls the source of income and its disposal.

In this case, the assets were formally transferred to the foundation. However, due to the mandate agreement, the founder never ceased to have control over them. The court noted that a mere possibility of the founder exercising influence sufficed, irrespective of whether such right was actually performed. ■



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Life Insurance Trusts

Trustee has non-waivable duty to keep beneficiaries informed about status of life insurance policies held in trust

Rafert v. Meyer, Nebraska Supreme Court, 2015 WL 832590, February 27, 2015

In an attempt to lower trustee fees, clients (settlors) often seek to relieve the trustee of duties associated with the administration of the trust assets, including the trustee's duty to pay premiums or other charges with respect to the life insurance policy.

The Nebraska Supreme Court recently clarified that a trustee has a non-waivable duty to keep beneficiaries informed about the status of life insurance policies held in the trust, and a non-waivable duty to act in good faith and in the best interests of the beneficiaries.

Facts. The settlor hired an attorney to create and serve as trustee of an irrevocable life insurance trust. The trust corpus was three insurance policies on the life of the settlor worth a total amount of $8.5 million. The policies were payable on the settlor's death to the trustee for the benefit of the settlor's four daughters.

The trust instrument stated expressly that the trustee had no duty to pay the insurance premiums, had no duty to notify the beneficiaries of nonpayment of such premiums, and had no liability for any nonpayment. The initial premiums were paid in 2009, but in 2010 the policies lapsed for nonpayment of the premiums. Neither the settlor, nor the trustee, nor the beneficiaries received notice from the insurers of the lapse until August 2012. The settlor and her daughters sued the trustee for breach of fiduciary duties.

Decision. The court held that no trust provision can limit a trustee's liability for breach of trust. It found untenable the trustee's argument that the trust deed expressly limited his liability for any claims related to the nonpayment of premiums. Relieving a trustee of these duties leaves the trust without anyone to assure that the policy in question remains in effect, that it is the correct policy for the trust, and that full advantage is being taken of its options and elections. ■

Recent cases highlight potential conflicts between beneficiary designations and best intentions of insured

Hearing v. Minnesota Life Insurance Company, 2014 WL 3587406 (U.S.D.C. ND IA 2014); Lincoln National Life Insurance Company v. Ruybal, 214 WL 3560293 (U.S.D.C. CO 2014)

Two recent decisions from the US Federal District Court emphasize the importance of ensuring that the designated beneficiaries in life insurance policies accurately reflect the intentions of the insured. In each case, the court ordered payment to the insured's named beneficiary, even though such designation conflicted with the insured's intended beneficiary.

Facts. The facts in both cases are similar; the father purchased a life insurance policy as part of a divorce agreement that required him to maintain $100,000 of life insurance until his child support obligation expired.

In order to prevent his wife from controlling the death proceeds, the father designated his sister as the beneficiary, rather than his child. The father died with the policy still designating the sister as beneficiary.

Handwritten notes were filed as evidence to show that the father intended for the child to be the beneficiary. There was no evidence, however, to show that the father did anything before his death to notify the insurance company of his intent to change the beneficiary.

Decision. The court held that a change of beneficiary request requires that the insured expressed a clear intention to change the beneficiary, and did all he or she could to notify the insurance company of his or her request in the manner provided in the policy.

The court found that the insured's handwritten note indicating that his child was the intended beneficiary was insufficient to constitute a request to change the beneficiary from the sister, who was the designated beneficiary, to the insured's child.

The court noted that anyone attacking the right of a named beneficiary to receive the proceeds of an insurance policy has the burden of proving that the beneficiary is not entitled to such proceeds. ■

Taxation of Trusts

Recent changes in Portugal bring trusts within scope of tax legislation

Portugal, like many civil-law jurisdictions, does not recognise the concept of trusts. As such, trusts have fallen outside the scope of Portugal's tax legislation.

As part of the country's efforts to increase its tax revenue, Portugal recently introduced changes in order to tax distributions from fiduciary structures, including trusts and foundations. These changes came into force on January 1, 2015.

Distributions. The new law now taxes the whole amount of any distributions made from a trust structure to residents of Portugal at the rate of 28%.

However, if the trust is domiciled in a listed tax haven country (a list published by the Ministry of Finance), then these distributions are taxed at a rate of 35%.

Liquidation. In the case of liquidation, revocation or winding-up of a trust, the assets distributed are taxed as follows:

- On distributions to the settlor, only the gain, rather than the whole amount, is taxed at the rate of 28%.
- On distributions to beneficiaries, there is no income tax payable. However, the distributions will be treated as a gift and these amounts will be subject to stamp duty at a flat rate of 10%.

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TRUST ADMINISTRATION

Important guidance for trustees on the decision-making process when reaching a "momentous decision"

In the Matter of the [AAA] Children's Trust, Royal Court of Guernsey, January 8, 2014

A recent ruling of the Royal Court of Guernsey provides a useful reminder of the importance for trustees to properly document their decision-making process to ensure that all their decisions can stand up to scrutiny. The case involved an application to the court by the trustees to approve their decision to sell a significant and valuable trust asset.

Facts. The property in question formed a substantial part of the trust assets and was referred to by the settlor as the "finest jewel in the jewel box". The settlor had left a letter of wishes to the trustees outlining his instructions that the property should only be sold in "exceptional circumstances" and then only "at an appropriately extraordinary price such that news will reach [me] even in heaven".

The settlor had acquired the property for his children to "protect their long term interests and security". He instructed his two children not to dispose of their interest until they reached the age of 40 and even then, he did not wish for them to sell it.

The trustee, however, wished to sell the property and their decision was supported by the protector of the trust, who was a long-time business associate of the settlor. The sale was opposed by all family members and by the advocate who had been appointed to represent the children, the unborn and the unascertained beneficiaries.

The trustees received an offer to purchase the jewel and applied to the court for authorization to sell the trust asset.

Decision. The Court took issue with the process that had been adopted by the trustees in coming to their decision to sell the property. The court held that the process adopted did not stand up to scrutiny. There was in fact no evidence of a clear-cut decision by the trustees to accept the offer to purchase from the purchaser. Rather, it emerged that there had been a "rolling decision" made over a long period of time, discussed via telephone and email. There were no file notes or records of the relevant factual information considered, nor were there comprehensive minutes of the trustee's deliberations.

Therefore, it was unclear whether or not a decision had in fact been made and/or what factors the trustees had taken into account in their decision-making process. As a result, the court declined the trustees' application to approve the sale.

Comments. Trustees must ensure that they can support their decisions no matter how big or small. Deliberating decisions via email and telephone are no real substitute for a properly convened trustee meeting. Best practice suggests a formal meeting should be convened when the matter to be resolved involves decision making around significant assets or investments or when making decisions to make distributions to beneficiaries. Prior to any trustee meeting being called, each trustee should receive a full dossier of information, including the agenda and supporting documents. ■

TRUST PRIVACY

Court orders reporting restrictions to protect wealthy beneficiaries

In re: Anonymised Judgments, Justice Morgan, England and Wales High Court, October 27, 2014

Facts. The settlor of three family trusts asked the court to vary the trusts' terms to the advantage of his minor beneficiaries and future unborn beneficiaries, and wished to hear the matter in private in order to protect the family from the negative effects of their wealth.

The parties argued that hearing the case in public would reveal that the trusts had very large assets, public knowledge of which would create a risk to the personal safety of the beneficiaries. They also stated that the trusts received large dividends from very profitable private companies, public knowledge of which would cause the companies' customers to react negatively and to squeeze the profits down. Finally, they asserted that the case involved uncontentious matters arising in the administration of trusts.

Decision. The court ruled that the parties' privacy and personal security is not a good enough reason for restricting publication, judging them to be insufficient to outweigh the strong presumption in favor of open justice. The court dismissed the argument, that the beneficiaries' personal safety required that they should remain anonymous, as "very slender indeed".

The court gave the most weight to the need to protect the five existing minor beneficiaries, all of whom were still under 10 years of age. This was particularly relevant because the parents were determined that the children should not know, at too young an age, the extent of the family's wealth, which they feared may deter them from obtaining a full education, making their own way in life, and contributing to society. Their good fortune, the parents feared, could also make them a magnet for false friends and fraudsters, as well as making them targets for criticism on social media.

While the court rejected the parties' request for a private hearing, it did rule that a court judgment concerning trust beneficiaries cannot be published without special permission by way of court order, and in any case must be anonymised in order to protect them from the adverse effects of their wealth. ■