



CHAPTER 8

WEALTH TRANSFER TAXATION IN THE UNITED KINGDOM

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8.1 HISTORICAL ORIENTATION AND INTRODUCTION

8.1.1 Historical Development

In 1894 a modern estate duty replaced most of the early death duties which had been imposed in the United Kingdom over a period of two hundred years since the initial introduction of probate duty in 1694.¹ Estate duty was charged on property passing from a deceased to his or her estate as well as on gifts made in a certain period before death, initially set at one year. No charge on gifts was made if the person survived the “gifts period”, which was amended from time to time.²

To counter the avoidance of estate duty through lifetime transfers and generation-skipping trusts, estate duty was replaced with yet another transferor-based tax, namely capital transfer tax, in 1975. Unlike estate duty, the ambit of capital transfer tax was extended to all capital gifts made during a person’s lifetime. In addition, the legislation introduced a special regime for discretionary trusts.³ Apparently, the lifetime aggregation of gifts acted as a disincentive for the transfer of wealth to younger generations, which led to unwelcome economic results.⁴ As a consequence, the long-standing approach of limiting the taxable gifts to the gifts made by the deceased in a certain period immediately prior to his or her death was reintroduced with the introduction of

¹ See Ch 3 par 3.2.3 n 11 and accompanying text for further reading on the early British death duties. Although probate duty, account duty and temporary estate duty were abolished with the introduction of the modern estate duty in 1894, succession duty and legacy duty remained in force until their eventual abolition in 1949.

² See Ch 3 par 3.2.3 n 13 and accompanying text. For further reading on the scope, structure and provisions of estate duty, see in general Lawton (1970) and Wallington (2002) div A2.

³ For further reading on the scope, structure and provisions of capital transfer tax, see in general Chapman (1980); Jones (1981); Hayton, Marsh, Tiley and Wignall (1984); McCutcheon (1984) and Wallington (2002) div A3.

⁴ Jarman (2006) 4.

inheritance tax in 1984, levied in terms of the Inheritance Tax Act (hereafter “the Act”),⁵ which is, as amended by the annual Finance Acts, still in force today.

Although this tax was, to a large extent, modelled on the earlier estate duty, the legal structure was modernised and the capital transfer tax regime for discretionary trusts was retained.⁶ The new system was generally perceived as being iniquitous, unfair, and complex.⁷ As a consequence, various tax law reform proposals have over the years been put forward.⁸ As already mentioned in Chapter 3, the recently published Mirrlees Review proposed that the current system should ideally be replaced by a recipient-based wealth transfer tax.⁹

8.1.2 Broad Overview of Inheritance Tax¹⁰

Inheritance tax is levied on all chargeable transfers of value made by an individual. The Act distinguishes between lifetime transfers, which mainly involve *inter vivos* gifts, and transfers on death. A lifetime transfer can either be immediately chargeable, or it can qualify as a potentially exempt transfer (a “PET”). In respect of both lifetime transfers and transfers on death, the Act provides for a broad spectrum of reliefs and exemptions.

A lifetime transfer is valued at the difference in the value of the transferor’s estate before and after the transfer. To calculate whether any inheritance is due in respect of an immediately chargeable lifetime transfer, the value of the transfer is aggregated with the

⁵ Act of 1984 c. 51.

⁶ For further reading on the core principles of inheritance tax upon its initial incorporation, see Wallington (2002) div A4.

⁷ See Sandford (1986) *Br Tax Rev* 142 and Walker (1986) *Br Tax Rev* 143–146.

⁸ See Ch 3 par 3.2.3.

⁹ See Ch 3 par 3.2.4.

¹⁰ For a brief outline of the main provisions of inheritance tax, see Tiley (2008) 1262–1273 and HMRC *Inheritance Tax Manual*, available at <http://www.hmrc.gov.uk/MANUALS/inhmanual/index.htm> (accessed on 30 November 2009).

cumulative total of the values transferred by any chargeable transfers made by the transferor during the seven years preceding the transfer. If this total does not exceed the “nil rate band” (a threshold set at £325 000 for the 2009/2010 tax year), no inheritance tax will be due. If, on the other hand, the total exceeds the nil rate band, inheritance tax will be payable on the value in excess of the threshold at a rate of 20 percent.¹¹

In the case of a person’s death, his or her estate comprises all the property to which he or she has been beneficially entitled (after deducting excluded property) and other allowable deductions. To calculate whether inheritance tax is payable in respect of the deceased estate (the deemed transfer on death), the value of the estate is added together with the value of all the immediately chargeable lifetime transfers and PETS. Inheritance tax will then be due on the value exceeding the nil rate band at a rate of 40 percent.¹² A credit is allowed for tax previously paid at 20 percent in respect of the immediately chargeable lifetime transfers included in the total value of the taxable estate. Where the value of the deceased estate reflects property received by the deceased within a period of five years prior to his or her death under a transfer in terms of which inheritance tax was payable, the inheritance tax charged in respect of such property will be reduced by a percentage of the inheritance tax charged on the first transfer (the so-called successive transfers relief). The percentage varies according to the period between the dates on the earlier transfer and the subsequent death.¹³

The Act contains a special regime for “settled property”, which will more fully be discussed in paragraph 8.6.3 below.

¹¹ S 7 read with Sch 1.

¹² S 7 read with Sch 1.

¹³ S 101(2). See in general Wallington (2002) par D1.65 for examples.

8.2 TAX BASE

8.2.1 Lifetime Transfers

Inheritance tax is charged on the value transferred by a chargeable transfer.¹⁴ A chargeable transfer is a transfer of value made by an individual, excluding an exempt transfer. Although the Act provides that inheritance tax is chargeable on dispositions made by an *individual* (which excludes companies and trusts), transfers of value by close companies can be apportioned and charged to inheritance tax in the hands of the participators.¹⁵

A transfer of value is a disposition, including a disposition effected by associated operations,¹⁶ made by the transferor as a result of which the transferor's estate immediately after the disposition is less than it would be but for the disposition and the amount by which it is less is the value transferred by the transfer.¹⁷ Although the term "disposition" is not defined under the Act, it includes any act that results in a loss in value to a person's estate, such as sales (for inadequate consideration), gifts, exchanges, loans, disclaimers, waivers and indeed any act by which the ownership of property or a right in property is lost in whole or in part. The creation, release or other extinguishment of a debt also qualifies as a disposition.¹⁸ Although this primary charging provision does not

¹⁴ S 1.

¹⁵ S 98.

¹⁶ S 272 "disposition". The effect of this provision is that operations (whether directly or indirectly and whether by way of two or more operations) can be associated so that their combined effect on the transferor's estate would be taken into account. Suppose, for example, that a controlling shareholder owns a 60 percent holding in a company. He donates half of the holding to his son, having first transferred half to his wife, who subsequently also transfers the shares to the son. The combined effect of these operations is to pass the controlling interest from father to son. The tax authorities could therefore use the associated operations provisions to tax the transfer of the controlling interest accordingly. See in general Wallington (2002) pars C1.15–C1.16 and Tiley (2008) 1294–1301.

¹⁷ S 3(1).

¹⁸ See in general Wallington (2002) pars C1.12–C1.13, C1.33 and Tiley (2008) 1278–1279.

presuppose any recipient (and for that matter any enrichment), it is apparently uncertain whether or not a disposition would include involuntary or unintentional acts. Both Wallington and Tiley submit that the term probably require some deliberate action by the disposer, as a consequence of which the accidental destruction of an asset would not constitute a disposition.¹⁹

To extend the tax base to cases where a person passively suffers an event which causes a loss to his or her estate, the Act provides that, where a person's estate is diminished as a result of an omission to exercise a right and another person's estate or settled property is increased in consequence thereof, such person will be treated as having made a disposition for value at the time when he or she could have exercised the right, unless the omission was not deliberate.²⁰ A failure to exercise an option, to collect a debt, to vote in respect of shares in a company or to appoint property to oneself under a general power of appointment would in principle all be treated as dispositions (provided that the requirements are complied with).²¹

As a consequence of the fact that the subject of taxation is restricted to natural persons only, the Act provides that any value-shifting arrangement in respect of a close company's unquoted share or loan capital be treated as having been made by the participators of the close company at the time of the alteration.²²

Except where the Act contains a special timing provision,²³ the date of the transfer is the date of the completion of an effective disposition, which should be determined in

¹⁹ Wallington (2002) par C1.12; Tiley (2008) 1278.

²⁰ S 3(3).

²¹ Tiley (2008) 1279–1280.

²² S 98. See in general Wallington (2002) par C1.19.

²³ E.g. an omission to exercise a right is deemed to occur at the latest time when the right could have been exercised (s 3(3)).

accordance with general property law principles.²⁴

Certain transfers are, however, *not* regarded as transfers for value, such as:²⁵

- transfers between unconnected persons made at arm's length not intended to confer gratuitous benefits (ordinary business transactions);²⁶
- maintenance payments to spouses, former spouses, certain dependant relatives or children (under the age of 18 or (if older than 18) until they cease to undergo full-time education or training);²⁷
- dispositions made which are allowable in computing the transferor's income tax or corporation tax;²⁸
- certain contributions to retirement benefits schemes, registered pension plans or certain qualifying non-UK pension schemes;²⁹
- dispositions by close companies into trusts for the benefit of their employees;³⁰
- certain administrative acts in respect of the administration of deceased estates, such as any variation (under a redistribution agreement) or disclaimer (repudiation), election or a renunciation of a claim to a legitim.³¹ This provision only prevents that these dispositions are treated and chargeable as individual transfers of value, in view of the fact that the Act provides elsewhere that these arrangements shall be treated as if they had been made by the deceased

²⁴ Wallington (2002) par C1.31.

²⁵ See ss 10–17. See also in general Wallington (2002) pars C1.42–C1.60 and Tiley (2008) 1284–1289.

²⁶ S 10.

²⁷ S 11.

²⁸ S 12(1).

²⁹ S 12(2).

³⁰ S 13.

³¹ S 17.

immediately before his or her death (and death constitutes a chargeable event under the Act, as more fully discussed in paragraph 8.2.2 below).³²

A lifetime transfer can either be immediately chargeable, or it can qualify as a potentially exempt transfer (a “PET”).³³

8.2.2 Transfers on Death

Transfers on death are, in general, charged as if the deceased had made a transfer of value immediately before his or her death at a value equal to the value of his or her estate immediately before death.³⁴

To counter the avoidance of tax by an individual who transfers an asset in circumstances where he or she continues to have the use and enjoyment of that asset, special rules, commonly referred to as the “gift with reservation of benefit rules”, were introduced in 1986.³⁵ For many years the gift with reservation of benefit rules was easy to circumvent and there were a few well-known arrangements to by-pass the inheritance tax implications, for example the so-called “Ingram”³⁶ and “Eversden”³⁷ schemes. Although

³² See ss 142, 143, 145 and 147. For further reading, see Wallington (2002) par C1.60 and division D4.

³³ See par 8.5.3.2.

³⁴ S 4(1). See in general Wallington (2002) par D1.01 and Tiley (2008) Ch 68.

³⁵ Finance Act 1986 s 102 read with Sch 20. For a discussion of these rules, see Wallington (2002) division C4; Tiley (2008) Ch 69 and McLaughlin (2007) *Taxationweb*, available at <http://www.taxationweb.co.uk/tax-articles/capital-taxes/gifts-with-reservation-the-rules-explained.html> (accessed on 20 June 2009).

³⁶ Following the decision of the House of Lords in the case of *IRC v Ingram* [1999] All ER 1 297, [1999] STC 37, where it was held that the reservation of a leasehold estate, subject to which the reversionary interest was given away, did not constitute a reservation of benefit out of the gift of the freehold estate. For a discussion of the case, see Chamberlain (1999) *Br Tax Rev* 152 *et seq* and Chamberlain and Whitehouse (2005) 23–24.

³⁷ Following the decision of the Court of Appeal (of England and Wales) in the case of *IRC v Eversden* [2003] EWCA siv 668, where it was held that a gift to a donee spouse in trust (and not outright) was excluded from the reservation of benefit rules (in view of the spousal exemption). See Chamberlain and Whitehouse (2005) 24–25 for a discussion of the facts.

legislative provisions were introduced to combat these avoidance techniques,³⁸ a more radical approach was implemented in 2003 when an income tax charge was introduced on pre-owned assets (POAT), a tax that is currently still in force.³⁹

8.2.3 Jurisdictional Basis

The jurisdictional basis of the inheritance tax is determined with reference to the domicile of the transferor or the location of the assets.

8.2.3.1 Domicile

Inheritance tax is primarily chargeable on the worldwide property of persons domiciled⁴⁰ in the United Kingdom.⁴¹

³⁸ See Finance Act 1986 ss 102A–C (anti-*Ingram*) and 102(5A)–(5C) (anti-*Eversden*). See Miller (1999) *Br Tax Rev* 367–370 and Chamberlain (1999) *Br Tax Rev* 430–434 (on a discussion of the anti-*Ingram* provisions). See Chamberlain and Whitehouse (2005) 24–25 for a general discussion on the anti-*Ingram* and anti-*Eversden* avoidance provisions.

³⁹ Finance Act 2004 s 84 read with Sch 15. POAT applies retrospectively to anyone who had carried out an unacceptable inheritance tax scheme since 18 March 1986, the date on which the reservation of benefits rules was introduced. For further reading, see Chamberlain (2004) *Br Tax Rev* 486 *et seq*; Chamberlain and Whitehouse (2005) and Campbell (2006) *Br Tax Rev* 599 *et seq*.

⁴⁰ A person can either have a domicile of origin (in the case of a minor) or a domicile of choice (in the case of a person who has reached the age of majority), but can never be domiciled in more than one country at the same time. Where a person is domiciled in the United Kingdom, he or she will only cease to be so domiciled if he or she emigrates to another country with the intention not to return to the United Kingdom. The person would have to break all ties with the country. See Sonneveldt Doctoral Thesis (2000) 151.

⁴¹ Although the Act does not expressly state this fact, it can be inferred from the exclusion of foreign property of persons domiciled outside the UK (see par 8.2.3.2). See also Jarman (2006) 21. Subject to certain exceptions, s 267 provides that a person who ceased to be so domiciled would for a subsequent period of three calendar years still be deemed to be a domiciliary of the country. Furthermore, a person who has been resident in the UK for income tax purposes in not less than 17 of the 20 years of assessment ending with the year of assessment in which he or she ceased to be so domiciled, would also be regarded as a domiciliary of the country. See in general Sonneveldt Doctoral Thesis (2000) 151 and Jarman (2006) 19–20.

8.2.3.2 Location of Assets

The Act provides that property (other than settled property)⁴² situated⁴³ outside the United Kingdom is excluded from the tax base if the person beneficially entitled to it is an individual domiciled outside the United Kingdom.⁴⁴ The effect of this provision is (except for implying that persons domiciled in the United Kingdom are liable for tax on worldwide assets)⁴⁵ that persons domiciled outside the United Kingdom are only liable for inheritance tax on assets located in the United Kingdom. However, certain types of property owned by persons domiciled elsewhere are specifically excluded from the tax base.⁴⁶

8.2.4 Double Taxation

The Act provides that relief for double taxation can either be afforded through double taxation agreements or through the granting of a tax credit in respect of wealth transfer taxes imposed by overseas territories attributable to property in respect of which inheritance tax is also payable.⁴⁷

⁴² See par 8.6.3.2 for the rules relating to the jurisdictional basis of settled property.

⁴³ The question whether or not property is located in the UK should be answered with reference to the common law. See Sonneveldt Doctoral Thesis (2000) 150.

⁴⁴ S 6(1).

⁴⁵ See par 8.2.3.1.

⁴⁶ S 6(3) excludes from property war certificates, national saving certificates, premium savings bonds, deposits with the National Savings Bank and certified SAYE savings arrangements owned by persons domiciled in the Channel Islands or the Isle of Man. S 6(4) read with s 155(1) provides that emoluments paid by the Government of any designated country to a member of a visiting force of that country (not being a British citizen) and any tangible movable property owned by such person, are excluded property. S 5(1)(b) furthermore excludes certain foreign-owned work of art (owned by a person domiciled outside the UK).

⁴⁷ Ss 158 and 159.

The double taxation agreements that were concluded under the estate duty and capital transfer tax regimes are still in force. The agreements which were concluded with France and Italy under the provisions of estate duty apply to transfers on death only.⁴⁸ Because the tax base was in general extended to cover all lifetime transfers with the introduction of capital transfer tax in 1975, the agreements concluded under that regime with Ireland, South Africa, United States of America, Netherlands and Sweden cover lifetime transfers and transfers on death. With the exception of the agreements entered into with Netherlands and Sweden (which were amended subsequent to the introduction of inheritance tax in 1986 to cater for some changes), the agreements will have to be adapted for the purposes of inheritance tax.⁴⁹ The only agreement entered into under the inheritance tax regime, namely the agreement entered into with Switzerland in 1994, covers transfers on death only,⁵⁰ arguably as a result of the introduction of the PET regime.

A full (unilateral) credit (equal to the amount of the overseas tax) is allowed where the property is situated in the foreign territory imposing the tax.⁵¹ However, provision is also made for a credit (calculated in terms of a specific formula)⁵² where (a) the property is situated neither in the overseas territory nor the United Kingdom, or (b) where the property is situated both in the overseas territory and the United Kingdom.⁵³ Where relief

⁴⁸ The treaties which were concluded with India and Pakistan are of limited effect because these countries have abolished their estate duties. See Tiley (2008) 1487; <http://www.hmrc.gov.uk/CTO/customerguide/page20.htm#11> (accessed on 20 November 2009).

⁴⁹ See Tiley (2008) 1487; HMRC *Inheritance Tax: Customer Guide*, available at <http://www.hmrc.gov.uk/CTO/customerguide/page20.htm#11> (accessed on 20 November 2009).

⁵⁰ See Double Taxation Relief (Taxes on Deceased Persons and Inheritances) (Switzerland) Statutory Instrument 1994/3214.

⁵¹ S 159(2).

⁵² The formula for the credit is $A/(A+B) \times C$, where A = amount inheritance tax payable, B = amount overseas tax payable and C = whichever of A and B is the smaller. See s 159(3).

⁵³ S 159(3).

can be granted in terms of a double taxation agreement or through unilateral relief, it is provided that relief shall be given under whichever method provides the greater relief.⁵⁴

8.2.5 Object of Taxation: Property

The object of taxation is the value of property transferred under a chargeable transfer measured by the net loss to the transferor's estate. It is therefore in general necessary to consider what constitutes the transferor's estate both before and after the transfer (for the purposes of both lifetime transfers and transfers on death). A person's "estate" includes primarily the aggregate of all the "property" to which he or she is or has been beneficially entitled, except that the estate of a person immediately before his or her death does not include excluded property.⁵⁵ "Property" is defined as including "rights and interests of any description, but does not include a settlement power".⁵⁶ ⁵⁷ The definition covers tangible property, intangible rights, debts and other rights capable of being valued.⁵⁸ Property (other than settled property) over which the taxpayer had a "general power" to dispose of as he or she deemed fit (if he or she were *sui iuris*) is also regarded as the property of such taxpayer.⁵⁹

For transfers on death, the Act provides furthermore that any changes in the value of the estate which have occurred by reason of the person's death should be taken into account as if they had occurred before death (but subject to an exception for (i) alterations in rights attached to unquoted shares or securities and (ii) the termination on the death of

⁵⁴ S 159(7).

⁵⁵ S 5(1). For an estate on death generally, see Wallington (2002) par D1.11. See also par 8.2.3.2 n 46 for the meaning of excluded property.

⁵⁶ "Settlement power means any power over, or exercisable (whether directly or indirectly) in relation to, settled property or settlement" (s 47A).

⁵⁷ S 272.

⁵⁸ See in general Wallington (2002) par C2.11. A mere *spes*, or a right which is unenforceable, is not regarded as property (Wallington (2002) par 2.16).

⁵⁹ S 5(2). See in general Wallington (2002) par C2.12.

any interest or the passing of any interest by survivorship).⁶⁰ Thus, a life policy payable on the death of the life insured to his or her estate will form part of the property of the deceased and will be subject to the chargeable transfer on death to his or her deceased estate. The value payable at death, and not the surrender value, will be taken into account. If the policy proceeds are, however, not payable to the deceased estate of the life insured, but to a third party, then the policy proceeds will not form part of the estate of the deceased.⁶¹

8.3 VALUATION

Accept for a few qualifications, property is generally valued in terms of a main valuation rule. Provision is, however, made for some favourable valuation rules in respect of business property and agricultural property, rules that will be more fully discussed in paragraph 8.5.2 below. Property should be valued at the actual date of the transfer.⁶²

8.3.1 Fair Market Value Rule

For the purposes of lifetime transfers, the difference in the total value of the transferor's estate before and after the transfer should be established. In most cases, however, the disposition is a gift of property, which means that the value of the property would represent the value of the chargeable transfer.⁶³ This will, however, not always be the case, especially where the loss to the transferor's estate is greater than the value of the property, for example where the transferor owns 51 percent shares in a company and gives two percent of them away.⁶⁴ For the purposes of transfers at death, the value of all

⁶⁰ S 171. The loss of goodwill on the death of the proprietor would, for example, be taken into account in valuing his or her business share. See Tiley (2008) 1310. For criticism on valuation in hindsight, see McCutcheon (1988) *Br Tax Rev* 431–433. For further reading, see Wallington (2002) par D1.14.

⁶¹ See Wallington (2002) par D1.14 and Tiley (2008) 1407.

⁶² *Duke of Buccleuch v IRC* [1967] 1 AC 506; *Ward v IRC* [1999] STC (SCD) 1.

⁶³ Wallington (2002) pars C2.01, H1.01.

⁶⁴ Wallington (2002) par C1.11. See also par C2.01.

the property owned by the deceased immediately prior to his or her death should be valued.⁶⁵

According to the general rule (in the absence of a qualification), property should be valued at the price which it might reasonably be expected to fetch if sold on the open market at the time of the transfer, provided that the price shall not be reduced on the ground that the whole property is to be placed on the market at one and the same time.⁶⁶ For the purposes of the valuation of unquoted shares, the Act directs that all the information which a prudent prospective purchaser might reasonably require for the purposes of a private agreement at arm's length should be assumed to be available to such prospective purchaser.⁶⁷

Where the right to dispose of any property has been contractually excluded or restricted (by virtue of, for example, an option agreement), the exclusion or restriction would be disregarded except to the extent that consideration in money or money's worth was given for it.⁶⁸ This provision has specifically been designed to counter artificial arrangements such as where the wealth holder has concluded an option agreement to sell property at a price which would be below market value on the date of transfer thereof.⁶⁹

⁶⁵ Wallington (2002) pars D1.14, H1.02.

⁶⁶ S 160. For general guidelines developed by the judiciary, see *IRC v Gray* [1994] STC 360, 371–372 and Wallington (2002) pars H2.02–H2.0.

⁶⁷ S 168. For further reading on the valuation of unquoted shares in practice, see Wallington (2002) pars H3.11 to H3.20; Tiley (2008) 1439 and Sutherland (1996) *Br Tax Rev* 397 *et seq.*

⁶⁸ S 163(1). See in general Wallington (2002) par H1.01 and H2.31. In the case of a lifetime transfer, the provision applies only where the restriction was created after 27 March 1974 (s 163(2)).

⁶⁹ The Act contains a few other specific anti-avoidance measures, such as the “related property rule” (s 161) and the rule providing that the market value of property will be used on the date of the actual delivery where the delivery takes place more than a year after the disposition (s 262). See in general Wallington (2002) pars H1.01 and H2.41.

8.4 TAXPAYER AND PAYMENT OF THE TAX

The transferor is primarily liable for tax due in respect of chargeable lifetime transfers.⁷⁰ If the tax remains unpaid after it ought to have been paid, the person whose estate has been increased by the transfer (i.e. the recipient) or the person in whom the property transferred is vested (beneficially or otherwise) or any person for whose benefit the property has been settled, will be accountable for payment of the tax.⁷¹ The person primarily liable for the tax on the value transferred on death is in general the personal representatives of the deceased.⁷² The Act also extends the liability to the person in whose name the property is vested (beneficially or otherwise) at any time after death, or who is beneficially entitled to an interest in possession, and any person for whose benefit any property was settled at death.⁷³

In respect of tax due on chargeable transfers in respect of settled property, the trustees of the settlement are primarily liable for the payment of the tax.⁷⁴ If the tax remains unpaid after the period it ought to have been paid, the liability is extended to any person entitled (beneficially or not) to an interest in possession of the settled property, any person for whose benefit the settled property or income there from is applied at or after the time of transfer and the settlor, in circumstances where the settlement was made during the lifetime of the settlor and the trustees are not for the time being resident in the United Kingdom.⁷⁵

⁷⁰ Ss 199(1) and 204(6). However, should the tax relate to additional tax due on immediately chargeable transfers or PETS due to the fact that the transferor died within seven years, the transferor (or his personal representatives) will not be so liable. The transferee will be accountable for the additional tax (s 204(7)).

⁷¹ Ss 199(1) and 204(6).

⁷² S 200(1)(a).

⁷³ S 200(1)(c) and (d). The liability is limited to the tax attributable to the extent of the particular property, s 204(3).

⁷⁴ Ss 201(a) and 204(6).

⁷⁵ Ss 201(b),(c),(d) and 204(6).

8.5 RELIEF MECHANISMS

The relief mechanisms provided under the Act take various forms. Firstly, there are dispositions which are treated as not being transfers of value.⁷⁶ Secondly, certain property is regarded as excluded property.⁷⁷ In addition, relief is provided by (a) the allowance of the deduction of accompanying liabilities, (b) the provision for favourable valuation rules for relevant business property and agricultural property, (c) the exemption of certain transfers and the allowance of a tax-free (lifetime) threshold (the so-called “nil rate band”) and (d) the provision for roll-over relief for non-agricultural woodlands.

8.5.1 Liabilities

The Act provides that the chargeable transfer should be measured with reference to the net loss to the transferor’s estate,⁷⁸ which is determined by calculating the difference in the value of the estate before and after the transfer. In calculating the value of an estate at any time, the Act specifies that the liabilities at that time should be taken into account, except as otherwise stated.⁷⁹ Where a liability is due to a person resident outside the United Kingdom, which neither falls to be discharged in the United Kingdom nor is a burden on property in the United Kingdom, such liability shall be taken to reduce the value of property outside the United Kingdom only.⁸⁰

A person’s liability for inheritance tax (chargeable as a result of a chargeable transfer) may be taken into account for the purposes of the value transferred, but not his or her liability for any other tax resulting from the transfer.⁸¹

⁷⁶ See par 8.2.1.

⁷⁷ See par 8.2.3.2 n 46.

⁷⁸ S 3(1).

⁷⁹ S 5(3).

⁸⁰ S 162(5). See in general Wallington (2002) par C2.34.

⁸¹ S 5(4). The transferor’s liability for inheritance tax on the transfer of value shall be calculated without making any allowance for the fact that the tax will not be due immediately (s 162(3)).

Expenses incurred by the transferor (except for his or her liability for inheritance tax) in making the transfer will, if borne by him or her, be left out of account. However, costs borne by the person benefiting from the transfer will be treated as reducing the value transferred.⁸²

For the purposes of transfers on death, an allowance is made for reasonable funeral costs.⁸³ Although executors' remuneration and administration costs are not deductible,⁸⁴ an allowance is granted for administration and realisation costs incurred in respect of foreign property, provided that the costs shall not exceed five percent of the value of that foreign property.⁸⁵

8.5.2 Preferential Valuations

8.5.2.1 Business Property

Special relief for business property was first introduced under the former capital transfer tax legislation in 1976.⁸⁶ Currently, the Act provides that the transfer of "relevant business property" of a "qualifying business"⁸⁷ may qualify for a reduction of either 50 or 100 percent of the value of the property transferred, provided that certain requirements

⁸² S 164.

⁸³ S 172. See in general Wallington (2002) par D1.42.

⁸⁴ Tiley (2008) 1448.

⁸⁵ S 173. See in general Wallington (2002) par D1.43.

⁸⁶ When the tax was first introduced, a 30 percent reduction of the value of business assets was allowed, a share in a partnership or a controlling holding in a company transferred. See Wallington (2002) par G1.01 for a discussion on the historical development of the relief.

⁸⁷ S 103 provides that a "qualifying business" includes a business carried on in the exercise of a profession or vocation unless carried on otherwise as for gain. Subject to certain exceptions, some businesses do not qualify for relief, such as businesses consisting "wholly or mainly" of the dealing in securities, stocks, shares, land or buildings and the making or holding of investments. See s 105(3) read with s 105(4) and Wallington (2002) par G1.12.

are met.⁸⁸ The relief can also be claimed on chargeable occasions arising on relevant business property held in trust.⁸⁹ The relief applies to lifetime transfers and transfers on death, as well as to both foreign and United Kingdom businesses.⁹⁰ It is automatically available and does not have to be claimed by the person liable for the tax.⁹¹ To counter tax avoidance, the Act requires that the property (or qualifying replacement property) must have been owned by the transferor throughout the two years immediately preceding the transfer.⁹²

Where a business is transferred during the life of the transferor, and the transferor (or the transferee) dies within seven years from such transfer, then the business property will only qualify for business relief (on the death transfer) if the business property was owned by the transferee throughout the period between the gift and the death of the transferor (or the earlier death of the transferee), subject to special rules for replacement property. The property should qualify as relevant business property at the time that the gift was made as well as at the time immediately before the death of the transferor (or the transferee).⁹³

⁸⁸ The following “relevant business property” will qualify for the 100 percent relief: property consisting of a business or an interest in a business (such as a share in a partnership) and any unquoted shares in a company. The following “relevant business property” will qualify for the 50 percent relief: quoted shares or securities, which gave the transferor, either by themselves or with other securities, control in the company; land or buildings, machinery or plant owned by the transferor, which was used wholly or mainly for the purposes of a business carried on by a company of which the transferor then had control or by a partnership of which he was then a partner; and land or buildings, machinery or plant, which was used mainly or wholly for the purposes of a business carried on by the transferor where the property was settled, but in respect of which the transferor was beneficially entitled to an interest in possession at the time of the transfer. S 104(a) read with s 105(1)(a), (b) and (bb) (for the 100 % relief) and s 104(b) read with s 105(1)(cc), (d) and (e) (for the 50% relief). See in general Wallington (2002) par G1.51 and Tiley (2008) 1411–1412.

⁸⁹ Wallington (2002) par G1.61.

⁹⁰ Wallington (2002) pars G1.02 and G1.11.

⁹¹ Wallington (2002) par G1.02.

⁹² S 106 read with s 107(1)(a). S 12 provides that assets which were not wholly or mainly used for business purposes within the two-year minimum ownership period preceding the transfer (“excepted assets”) will be excluded from the relief. See in general Wallington (2002) par G1.54.

⁹³ S 113A. See in general Wallington (2002) par G1.91.

8.5.2.2 *Agricultural Property*

Relief is in principle granted to agricultural property, situated in the United Kingdom, the Channel Islands or the Isle of Man, which forms part of a working farm and which is transferred by virtue of a transfer of value (during life or on death).⁹⁴ Where the whole or part of the value transferred is attributable to the agricultural value of agricultural property, the value of such property shall be reduced by either 100 or 50 percent.⁹⁵ The relief also applies to settled property (whether or not any beneficiary has an interest in possession),⁹⁶ as well as to controlling interests in farming companies (to the extent that the value of the shares or securities is attributable to agricultural property).⁹⁷ The relief is automatically available and does not have to be claimed.⁹⁸ In the calculation of the relief, any mortgages or secured liabilities are taken into consideration.⁹⁹

⁹⁴ Agricultural property means agricultural land or pasture situated in the UK, the Channel Island or the Isle of Man and includes “woodland and any building used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and also includes such cottages, farm buildings and farmhouses, together with the land occupied with them, as are of a character appropriate to the property” (s 115(2) read with s 115(5)). The breeding and rearing of horses on a stud farm shall also be taken to be agricultural (s 115(4)). See also Wallington (2002) par G3.03 and Tiley (2008) 1419 for further reading.

⁹⁵ The transfer will qualify for 100 percent relief in the following instances: where the transferor has vacant possession of agricultural property (or the right to obtain it within the next twelve months); or where the transferor does not have vacant possession because the property has been let on a tenancy, beginning on or after 1 September 1995 (subject to certain transitional arrangements). Relief is due at a lower rate of 50 percent in any other case, principally where the property had been let under a tenancy starting before 1 September 1995 (where the transitional arrangements are not applicable). See s 116(1) read with s 116(2) and Wallington (2002) pars G3.02 and G3.04.

⁹⁶ S 115(1). See in general Wallington (2002) pars G3.51–G3.53.

⁹⁷ S 122. See in general Wallington (2002) pars G3.31–G3.40.

⁹⁸ Wallington par G3.01.

⁹⁹ E.g., A dies owning agricultural land valued at £250 000 let under a tenancy granted before 1 September 1995. The rate of relief is 50%. The agricultural value of the agricultural property transferred amounts to £200 000. The property is subject to a mortgage of £60 000. The chargeable value of the agricultural property is calculated as follows: £200 000–£48 000 ($£200\,000/£250\,000 \times £60\,000$) = £152 000. $50\% \times £152\,000 = £76\,000$. The chargeable value of the non-agricultural property is calculated as follows: £50 000–£12 000 (balance of mortgage) = £38 000. The total chargeable value of the property is therefore £76 000 + £38 000 = £114 000. See <http://www.hmrc.gov.uk/cto/customerguide/page17.htm#8> (accessed on 19 June 2009).

For the application of the relief, the Act requires a minimum period of occupation or ownership. Where the transferor occupied the property for agricultural purposes,¹⁰⁰ the Act requires that he or she must have occupied the property as such for a period of at least two years preceding the transfer. Where, on the other hand, the transferor had not occupied the property as such (for example where it had been let under a tenancy), such transferor must have owned the property for at least seven years before the transfer (during which period it had been occupied for agricultural purposes by him/her or another person).¹⁰¹

Where agricultural property is transferred during the life of the transferor, and the transferor (or the transferee) has died within seven years from such transfer, then the property may only qualify for agricultural relief (on the death transfer) if the property was owned by the transferee throughout the period between the gift and the death of the transferor (or the earlier death of the transferee), subject to special rules for replacement property. The property should also have qualified as agricultural property at the time that the gift was made as well as at the time immediately before the death of the transferor (or the transferee). The property should furthermore have been occupied for agricultural purposes throughout the period between the gift and the death.¹⁰²

Where the conditions for both agricultural and business relief are satisfied, then agricultural relief rather than business relief is available.¹⁰³ However, business relief may be available in respect of agricultural properties which do not qualify for agricultural relief, such as assets of farming businesses other than land and buildings and non-controlling unquoted shareholdings in farming companies.¹⁰⁴

¹⁰⁰ It is provided that occupation by a company which is controlled by the transferor shall be treated as occupation by the transferor (s 119). See in general Wallington (2002) par G3.12.

¹⁰¹ S 117. See in general Wallington (2002) pars G3.11 and G3.21.

¹⁰² S 124A. See in general Wallington (2002) pars G3.81–G3.81C.

¹⁰³ S 114.

¹⁰⁴ Wallington (2002) par G3.01.

Some commentators question the provision for special valuation rules for certain properties in that these rules create horizontal inequality between these properties and other assets.¹⁰⁵

8.5.3 Exempt Transfers

8.5.3.1 Exemptions Applicable to both Lifetime Transfers and Transfers on Death

The following transfers are exempt from tax, whether they occur during life or whether they occur on death:

- provided that certain conditions are met,¹⁰⁶ transfers to a charity,¹⁰⁷ a political party,¹⁰⁸ any registered housing association¹⁰⁹ or an institution such as the National Gallery, the British Museum and the Historic Buildings and Monuments Commission of England, any local authority, any government department, any university or university college in the United Kingdom¹¹⁰ and property that becomes part of a maintenance fund for historic buildings;¹¹¹

¹⁰⁵ See e.g. Sweet & Maxwell (1992) *Br Tax Rev* 238; Tiley (2008) 1259.

¹⁰⁶ For a discussion of these conditions, see Tiley (2008) Ch 75. Broadly speaking, the requirements are as follows: (i) a transfer must not take effect on the termination, after the transfer of value, of any interest or period; (ii) the transfer must not depend on a condition which is not satisfied within 12 months after the transfer; (iii) the gift must not be defeasible (determined 12 months after the transfer); (iv) the interest given must not be less than the donor's gain and (v) the property must not be given for a limited period. See s 23(2)–(5).

¹⁰⁷ S 23. See in general Wallington (2002) pars C3.33 and D2.15.

¹⁰⁸ S 24. See in general Wallington (2002) pars C3.34 and D2.16.

¹⁰⁹ S 24A. See in general Wallington (2002) pars C3.35 and D2.17.

¹¹⁰ S 25 read with Sch 3. See in general Wallington (2002) pars C3.36 and D2.18. See also Stebbings (1996) *Br Tax Rev* 542–543 for a historic description of this exemption that was first introduced in 1896, more than 110 years ago.

¹¹¹ S 27. See in general Wallington (2002) pars C3.38 and D2.20.

- provided that certain conditions are met, a transfer of value which includes national heritage property (such as pictures, books, works of art, land or buildings of national, scientific, historic, artistic or scenic interest) where the transferee gives certain undertakings to preserve the property and allow public access to it;¹¹²
- a loan made to a borrower in one of the exempt categories (such as loans of work of art to a museum);¹¹³
- provided that certain conditions are met, a transfer of value to the extent that the value transferred is attributable to property which becomes comprised in the estate of the transferor's spouse¹¹⁴ or civil partner or, so far as the value transferred is not so attributable, to the extent that the estate is increased (but subject thereto that, where the transferor is domiciled in the United Kingdom, but the transferee-spouse is not so domiciled, the exemption will be limited to £55 000 less any amount previously taken into account for the purposes of the relief);¹¹⁵ and
- provided that certain conditions are met, a transfer of value made by an individual who is beneficially entitled to shares in a company, to the extent that the value transferred is attributable to shares in or securities of the company which become comprised in an employee share purchase trust.¹¹⁶

¹¹² Ss 30–35. See in general Wallington (2002) pars C3.43, D2.24 and division G5.

¹¹³ S 29. See in general Wallington (2002) par C3.42.

¹¹⁴ There is no explicit definition for the term “spouse” in the Act, but under UK law it means lawfully wedded husband or wife. See Wallington (2002) par D2.12. The restriction of the inheritance tax exemption to married couples and couples registered under the Civil Partnership Act was challenged by two sisters (the Burden sisters) who have spent their lives living together. In April 2008 the majority of the judges of the Grand Chamber of the European Court of Human Rights (15 to 2) held in *Burden v United Kingdom* (13378/05) [2008] STC 1305 (ECHR (Grand Chamber)) par 66 that the difference in treatment does not constitute discrimination. Broadly speaking, academic commentators criticised the Grand Chamber's reasoning. See e.g. Sloan (2008) *Cambr Law J* 485; Baker (2008) *Br Tax Rev* 332 and Dempsey (2009) *Scolag Legal J* 38. However, the denial of the favourable tax treatment to the Burden sisters has awakened some emotional criticism in the media. See e.g. Knight “Two Old Ladies and a Blinding Injustice” *The Sunday Times* (17 December 2006), available at <http://www.timesonline.co.uk> (accessed on 8 July 2009).

¹¹⁵ S 18(1) read with ss 18(2) and 18(3)(a) and (b). See in general Wallington (2002) pars C3.32 and D2.14 and Tiley (2008) 1393–1394.

¹¹⁶ S 28. See in general Wallington (2002) par C3.41.

8.5.3.2 Exemptions Applicable to Lifetime Transfers Only

Lifetime transfers that may qualify for PET status include a transfer to (a) another individual, or (b) a disabled trust or (c) a bereaved minor's trust.^{117 118} A PET will in general only be taxable if the transferor dies within seven years after the date of the transfer. If the transferor survives the seven-year period, the transfer is exempt.¹¹⁹ However, where the transferor dies between three and seven years after making the gift, any inheritance tax due is reduced on a sliding scale. This is known as "taper relief".¹²⁰ Tiley questions whether there should be such a marked absence of tax neutrality as to the timing of gifts.¹²¹ It is therefore not surprising that the recently published Mirrlees Review suggested that the life-time exemption of gifts needs to be re-examined, in view of the fact that it has a negative impact on the equity of the system.¹²²

The following gifts are exempt from inheritance tax (whether or not they qualify for PET status):

- a small gift that does not exceed a certain value (£250 for the 2009/2010 tax year);¹²³
- any payments made out of income by the transferor as part of his or her normal expenditure, such as monthly or other regular payments to someone, regular gifts for Christmas and birthdays or anniversaries and regular premiums on a life insurance policy;¹²⁴ and

¹¹⁷ See par 8.6.3.5 for further reading on the bereaved minor's trust.

¹¹⁸ S 3A(1A)(a)–(c). Where the transfer was made before 22 March 2006, the transfers that would have qualified for PET status included a transfer to (a) another individual, or (b) an accumulation and maintenance trust (A&M trust) or (c) a disabled trust. See s 3A(1)(a)–(c). See par 8.6.3.5 n 193 for the meaning of an A&M trust. Note that this type of trust was basically replaced by the bereaved minor's trust as a consequence of the amendments affected to the Act in 2006.

¹¹⁹ S 3A(4) and (5).

¹²⁰ See ss 131–140.

¹²¹ Tiley (2008) 1259.

¹²² Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 17–18.

¹²³ S 20. This exemption does not apply to the first £250 of a larger gift. See Wallington (2002) par C3.24.

¹²⁴ S 21. See in general Wallington (2002) par C3.25 and division G5.

- any gift in consideration of marriage or civil partnership, limited to a certain amount (for the 2009/2010 tax year the limitations are as follows: £5 000 in respect of a gift by a parent to the party of the marriage; £2 500 in respect of gifts by grandparents and other close relatives and £1 000 for all other cases).¹²⁵

In addition, the Act provides for an exemption of £3 000 in respect of lifetime transfers of value made by a transferor in one calendar year.¹²⁶

8.5.3.3 *Exemptions Applicable to Transfers on Death Only*

The Act provides for the exemption of a transfer of value upon the death of a person who died in active service against an enemy or in other services of a warlike nature.¹²⁷

8.5.3.4 *The Nil Rate Band*

The nil rate band (referred to in paragraph 8.1.2 above) is the amount up to which a transferor will not have to pay inheritance tax. The transferor will only pay tax on the value of a transfer that exceeds the aggregate value of all the chargeable transfers made by him or her in the period of seven years immediately preceding the first-mentioned transfer. This may already happen during his or her lifetime, or it may happen at death. The value of the nil rate band is adjusted for inflation on an annual basis.¹²⁸

Since 9 October 2007, a surviving spouse or civil partner may, in addition to his or her own nil rate band, also be entitled to any unused part of his or her deceased former

¹²⁵ S 22. See in general Wallington (2002) par C3.26.

¹²⁶ S 19 (1). Any unutilised balance of the annual exemption may be carried over to the second year (s 19(2)). See in general Wallington (2002) par C3.22.

¹²⁷ The death should be so certified by the Defence Council or the Secretary of State (s 154). See in general Wallington (2002) par D2.11.

¹²⁸ See Sch 1.

spouse or partner's nil rate band.¹²⁹ Broadly speaking, scholars welcomed the amendment as a measure to eliminate the estate planning schemes that existed to ensure that both spouses' rebates are utilised.¹³⁰

8.5.4 Roll-over Relief: Non-Agricultural Woodlands

A special form of relief is available in respect of property in the United Kingdom on which trees and underwood are growing which is transferred on the death of a person and which is not agricultural property within the meaning as described above. If the person liable for the payment of the tax so elects,¹³¹ the payment of inheritance tax in respect of the value of the trees and underwood may be deferred until it has been disposed of (whether together with or apart from the land on which they were growing).¹³² The inheritance tax chargeable on the later disposal will be calculated on the net proceeds of the sale (or the net value of the trees in any other case) at the rate or rates at which it would have been charged on the death of the former transferor.¹³³

The relief will apply only where the deceased was either beneficially entitled to the land throughout a period of five years immediately preceding his or her death, or became entitled to it otherwise than for money or money's worth (i.e. by virtue of a gift or an inheritance).¹³⁴ Unlike the position under the agricultural relief, this relief is not available

¹²⁹ S 8A–C. See <http://www.hmrc.gov.uk/inheritancetax/info/transfer-threshold.htm> (accessed on 1 July 2009).

¹³⁰ See Chamberlain (2007) *Br Tax Rev* 662 *et seq* and Campbell (2008) *Br Tax Rev* 423 *et seq* and Harris (2009) *Busy Practitioner* 4.

¹³¹ An election must be made by notice in writing to the Board within 2 years of the death or such longer period as the Board may allow (s 125(3)).

¹³² Ss 125 and 126. See Wallington (2002) pars G4.01–G4.08 for further reading.

¹³³ Ss 127 and 128.

¹³⁴ S 125(b).

where the woodlands are owned by a company in which the deceased held a controlling shareholding.¹³⁵

8.6 TREATMENT OF SETTLED PROPERTY (TRUSTS)

8.6.1 Trusts: A Classification

Although English trusts¹³⁶ can be classified according to several criteria,¹³⁷ it suffices to, for wealth transfers tax purposes, distinguish between fixed interest trusts and discretionary trusts. A fixed interest trust (or interest in possession trust) is a trust in which a beneficiary has a present fixed entitlement to an ascertainable part of the net income (after any administrative expenses have been deducted). The life tenant, who is regarded as the beneficial owner of the underlying property,¹³⁸ has a so-called “interest in possession” in the trust property, meaning a “present right to the present enjoyment” of the property.¹³⁹ This description was confirmed by the House of Lords in *Pearson v IRC*.¹⁴⁰ The most common type of interest in possession trust is the so-called life interest trust, for example where property is settled in trust for A for life with the remainder to

¹³⁵ Wallington (2002) par G4.01.

¹³⁶ See Ch 5 par 5.6.1.1 for a brief discussion of the origin and development of trusts in England.

¹³⁷ The general classification based on the way in which the trusts are created is (i) express trusts; (ii) resulting trusts, (iii) constructive trusts, and (iv) statutory trusts. See Sonneveldt in Sonneveldt and Van Mens eds (1992) 8–9.

¹³⁸ See Ch 5 par 5.6.1.1.

¹³⁹ Sonneveldt in Sonneveldt and Van Mens eds (1992) 10; Sonneveldt Doctoral Thesis (2000) 153; Jarman (2006) 17–18. See also definition of a interest in possession trust at <http://www.hmrc.gov.uk/trusts/types/bare.htm> (accessed on 21 June 2009).

¹⁴⁰ STC [1980] 318 323. See Wallington (2002) par E1.41 for a comprehensive discussion of the case. Tiley (2008) 1352 mentions that if a person has, for example, a life interest and there is no power to withhold income from him or her short of depriving him or her from capital, that person would have an interest in possession notwithstanding that no income may in fact arise. Where, however, the trustees have the power to accumulate the income, the *Pearson* case has established that the beneficiary would not have an interest in possession. See Tiley (2008) 1351–1352 and Jarman (2006) 18 for a discussion of the case.

B.¹⁴¹ The beneficiary who is entitled to the income of the trust is known as the “life tenant”, whereas the beneficiary who is entitled to the remainder or the reversion of the trust capital is known as the “remainderman”.¹⁴² It is noteworthy to mention that, although a life interest may seem similar to the Roman law usufruct (a concept that can readily be found in many civil-law systems), these concepts are quite different in that a usufructuary interest may not be alienated, whereas a person may dispose of a life interest.¹⁴³ In a discretionary trust the trustees are the legal owners of the property held in trust, which they then administer for the benefit of members of a class of beneficiaries. The beneficiaries do not have interests in possession in the trust property. The trustees have a discretion (conferred on them by the settlor of the trust) to decide how to distribute the income and/or capital of the trust among the beneficiaries.¹⁴⁴

8.6.2 A Brief History on the Development of the Treatment of Trusts for Wealth Transfer Tax Purposes

When estate duty was introduced in 1894, it was provided that a beneficiary with an “interest in possession” in settled property was chargeable to estate duty as if that beneficiary owned the underlying trust property outright.¹⁴⁵ In 1969 the application of the duty was for the first time reformed to extend to discretionary trusts, where beneficiaries do not have interests in possession to the trust property. However, the duty was in general only charged where a deceased was eligible to benefit and indeed benefited from the income within the seven years prior to his or her death. If such beneficiary, for instance,

¹⁴¹ Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10–11.

¹⁴² Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10.

¹⁴³ Lyons (2009) *Private Client Business* 34 n 5 and accompanying text.

¹⁴⁴ Sonneveldt in Sonneveldt and Van Mens *eds* (1992) 10.

¹⁴⁵ Coombes (1977) 5; Chamberlain (2006) *Br Tax Rev* 625.

received a third of the trust income during that period, a third of the trust capital would have been subject to duty.¹⁴⁶

Capital transfer tax, which was introduced in 1975, adopted the same approach as estate duty in respect of interests in possession. In respect of discretionary trusts, a much more direct approach was introduced by the implementation of periodic charges on the settled property, the broad aim of which was to provide for a regime akin to a full charge to the tax once a generation. In addition, the cessation of property as relevant property was deemed to be a chargeable transfer by the trust to the beneficiary and was fully taxable. Apparently, this regime was perceived to be relatively onerous. As a consequence, the legislature refined the system in 1982. The regime provided for a 10-year anniversary charge for “relevant property” settlements (discretionary trust funds) as well as exit charges in respect of property that ceased to be so held in trust. Apparently, the relevant property regime was widely accepted to be fair.¹⁴⁷

When capital transfer tax was replaced with inheritance tax in 1984, the dual-system regime for trusts (interest in possession regime (IIP regime) and relevant property regime) was initially replicated in the new legal structure.¹⁴⁸ In view of the fact that inheritance tax, unlike capital transfer tax, taxed lifetime transfers only where they occurred in a stated period before death (the PET regime), the legislation was adapted to provide that a transfer of an asset into an interest in possession trust (on or after 17 March 1987) could also qualify as a PET. This approach was based on the fact that a beneficiary of an interest in possession in settled property was generally treated as having an interest in the property underlying that interest.¹⁴⁹ The transfer could therefore possibly have

¹⁴⁶ Report by Chancellor of the Exchequer *Cmnd 4930* (1972) 3.

¹⁴⁷ Chamberlain (2006) *Br Tax Rev* 626; Jarman (2006) 4 and 43.

¹⁴⁸ Jarman (2006) 4.

¹⁴⁹ S 49 (prior to its amendment in 2006).

escaped tax if the transferor did not die within the seven-year period.¹⁵⁰ However, the operation of the PET regime in respect of interest in possession trusts (IIP trusts) was the backbone of many effective estate planning techniques.¹⁵¹ To counter this form of tax avoidance, the Act was amended (with effect from 22 March 2006) to provide that most interests in possession would not be treated as the outright property of the beneficiary anymore. The relevant property regime was furthermore extended to operate in respect of most IIP trusts.¹⁵² The new regime will be discussed more fully below.

8.6.3 Treatment of Trusts under the Inheritance Tax Act: The Contemporary Position

8.6.3.1 General: The Meaning of Settled Property, Interest in Possession and Reversionary Interest

The Inheritance Tax Act contains a special regime for “settled property” in Part III of the Act. Before embarking on a discussion on this regime, it is firstly necessary to evaluate the meaning of the term “settled property”. In terms of the Act, settled property includes property held in trust for successive beneficiaries or for any person subject to a contingency (such as the future birth of a beneficiary). It also includes property held in trust where the trustees have the power to accumulate the trust income or where such income is payable at the discretion of the trustees (or someone else). The term furthermore includes property charged or burdened (otherwise than for full consideration

¹⁵⁰ See Sonneveldt Doctoral Thesis (2000) 156; Tiley (2008) 1345 and Jarman (2006) 35.

¹⁵¹ It was, for example, very common on the death of a life tenant for the assets to pass to an interest in possession trust for the benefit of the deceased’s spouse (which would have qualified as an exempt transfer). If the spouse’s interest in possession was consequently terminated, for example by transferring the interest to a child, and the spouse survived the seven-year period, the transfer of the interest could have qualified as a PET and could therefore have escaped inheritance tax indefinitely. See Chamberlain (2006) *Br Tax Rev* 630; Jarman (2006) 5 and Tiley (2008) 1347.

¹⁵² See Whitehouse (2006) *Br Tax Rev* 206 *et seq*; Chamberlain (2006) *Br Tax Rev* 625 *et seq* and Jarman (2006) 5–13 for a broad overview of the changes effected by the 2006 amendments.

in money or money's worth) with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period. The concept also extends to property that is held under similar arrangements governed by the laws of another country.¹⁵³ Although the description of settled property principally includes property held in trust, it also deems certain other property (other than trust property) to be settled property, for example a lease of property which is for life or lives, or for a period ascertainable only by reference to a death (unless the lease was granted for full consideration).¹⁵⁴ For inheritance tax purposes, each item of settled property is regarded as having its own identity. For example, where one item of settled property within a trust may be used at the discretion of the trustees, whereas another item within the same trust is set aside for the benefit of a disabled person, each item will be treated separately.¹⁵⁵

In view of the fact that the Act does not contain a special definition for an interest in possession (except for Scotland only),¹⁵⁶ its meaning is established by reference to the principles of ordinary trust and property law, which have already been described above as a "present right to the present enjoyment of property".¹⁵⁷ In practice, the taxing authorities treat a foreign usufruct as the equivalent of a life interest in a settlement, despite their apparent differences.¹⁵⁸ A "reversionary interest" refers to "a future interest under a settlement, whether it is vested or contingent (including an interest expectant on the termination of an interest in possession ...)".¹⁵⁹ Thus, under United Kingdom law, bare

¹⁵³ S 43 (1) and (2). See in general Wallington (2002) pars E1.11–E1.16. For arrangements that fall outside the definition, see Wallington (2002) par E1.17.

¹⁵⁴ S 43(3). See in general Wallington (2002) par H2.22; Tiley (2008) 1341–1343 and Jarman (2006) 30.

¹⁵⁵ HMRC *Inheritance Tax and Settled Property*, available at <http://www.hmrc.gov.uk/trusts/iht/intro.htm> (accessed on 29 June 2009).

¹⁵⁶ Tiley (2008) 1351 n 3 mentions that s 46 refers to "an interest of any kind under a settlement actually being enjoyed by the person in right of that interest".

¹⁵⁷ See par 8.6.1.

¹⁵⁸ Lyons (2009) *Private Client Business* 40.

¹⁵⁹ S 47.

dominium property will be classified as a reversionary interest. Because limited interests and bare *dominium* is a problematic area under the South African law, the approach to these interests under the inheritance tax regime will be discussed more fully in paragraph 8.7 below.

8.6.3.2 *Jurisdictional Basis*

Settled property (other than a reversionary interest in such property), situated outside the United Kingdom, is excluded from the tax base if the settlor was domiciled outside the United Kingdom when the settlement was made.¹⁶⁰ The settled property will, however, not be excluded if a person is or was at any time entitled to an interest in possession in the property at a time when he or she was domiciled in the United Kingdom and the entitlement arose as a result of a disposition made on or after 5 December 2005 for a consideration in money or money's worth.¹⁶¹ A reversionary interest in such settled property, situated outside the United Kingdom, will also be excluded from the tax base where the person beneficially entitled to it is not domiciled in the United Kingdom.¹⁶² If the person, however, subsequently acquires United Kingdom domicile, the reversion will lose its exclusion.¹⁶³

¹⁶⁰ S 48(3)(a). Jarman (2006) 22 mentions that the establishment of a so-called "excluded property settlement" has therefore become near-standard planning for a person who is planning to live in the UK but is not yet domiciled in the country.

¹⁶¹ S 48 (3B). This provision was inserted to counter the popular estate planning scheme whereby a UK domiciled taxpayer purchased substantial life and reversionary interests in an offshore settlement established by a non-UK domiciled settler. See Campbell (2006) *Br Tax Rev* 44–45. It has been said that, although the purpose of the amendment is laudable, its wording is wider than its purpose requires and may have an adverse effect on innocent UK emigrants, resulting in unnecessary double taxation. See Harper (2006) *Br Tax Rev* 638–642.

¹⁶² S 48(3)(b) read together with s 6(1).

¹⁶³ Jarman (2006) 22.

The following discussion will set out the contemporary inheritance tax consequences (subsequent to the amendments that were effected on 22 March 2006) in relation to fixed trusts, discretionary trusts and special purpose/charitable trusts.

8.6.3.3 Fixed Interest Trusts (Interest in Possession Trusts)

Although the *inter vivos* creation of an interest in possession settlement could usually have qualified as a PET prior to the 2006 changes, such a creation will now generally qualify as an immediately chargeable transfer, unless the transfer creates a disabled person's interest, which may still qualify as a PET under the new rules.¹⁶⁴

In the instance where a beneficiary became beneficially entitled to an interest in possession prior to 22 March 2006, the Act provides that such an interest will still continue to be treated according to the old IIP regime. The underlying settled property will therefore be regarded as the outright property of the beneficiary.¹⁶⁵ As a consequence, any subsequent disposal or termination of such an interest (during the lifetime of the beneficiary) will (except to the extent that it constitutes excluded property) be deemed to constitute a transfer of value equal to the value of the underlying property reduced by the value of any consideration received.¹⁶⁶ Furthermore, in the event of the beneficiary's death, the underlying settled property will (except to the extent that it comprises excluded property) form part of the beneficiary's deceased estate.¹⁶⁷ All the usual reliefs and exemptions on death will be available.¹⁶⁸

¹⁶⁴ HMRC *Inheritance Tax on Transfers into Trust*, available at <http://www.hmrc.gov.uk/trusts/iht/transfers-in.htm> (accessed on 27 June 2009); Whitehouse (2006) *Br Tax Rev* 209; Jarman (2006) 72.

¹⁶⁵ Ss 49(1) and (1B). However, where the trust is revocable (a so-called "grantor trust"), the assets held in trust will still be regarded as part of the settlor's estate. See Lupoi (2000) 104.

¹⁶⁶ S 52(1) and (2) read with ss 51, 49 and 52(2). See in general Jarman (2006) 31.

¹⁶⁷ S 49 read with s 4. See in general Jarman (2006) 31.

¹⁶⁸ S 49 read with s 4. See in general Jarman (2006) 31. For the purposes of both lifetime transfers and transfers on death, the transfer will not be chargeable where the interest in possession reverts to the settlor, or where the settlor's spouse or his or her widow or widower domiciled in the UK becomes beneficially entitled to such an interest, unless such person acquired a reversionary interest in the property for a

Footnote continues on the next page

On the other hand, where a beneficiary becomes beneficially entitled to an interest in possession on or after 22 March 2006, the beneficiary will not be regarded as the outright owner of the underlying settled property (save for a few exceptions, namely where the interest constitutes an immediate post-death interest,¹⁶⁹ a disabled person's interest¹⁷⁰ or a transitional serial interest¹⁷¹).¹⁷² The effect of this provision is that any subsequent disposal, termination or death (of the beneficiary) will not constitute a chargeable event.¹⁷³ However, such an IIP trust will now be subject to the special "relevant property" regime applicable to discretionary trusts, which includes the 10-year anniversary charge and the exit charges, as will be discussed more fully in paragraph 8.6.3.4 below.

In keeping with the rule to either attribute the full value of an interest in possession to the beneficiary, or to subject the IIP trust to the relevant property regime, a reversionary

consideration in money or money's worth. See ss 53(3)–(5) and 54(1)–(3) and 54(2A). See also Jarman (2006) 38.

¹⁶⁹ An "immediate post-death interest" is an interest in possession in settled property created by a will or under the law relating to intestacy where the beneficiary becomes beneficially entitled to the interest on the death of the testator or intestate. Such an interest would continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 49A.

¹⁷⁰ A "disabled person's interest" is an interest under a trust set up for someone with a mental or physical disability. Such an interest would continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 89.

¹⁷¹ In view of the fact that the 2006 amendments were far-reaching in respect of most IIPs, the legislature provided for a transitional period. Before 5 October 2008, a beneficiary (who became beneficially entitled to an interest in possession before 22 March 2006) could choose to pass on his or her interests in possession to other beneficiaries (for example his/her children). This was called the making of a "transitional serial interest" (TSI). If such a TSI trust was set up before 5 October 2008, the beneficiaries can continue to be treated according to the old IIP rules. As a consequence, there would be no 10-yearly charge. See s 49C. After 5 October 2008, a TSI can no longer be created during the life of the IIP beneficiary and the trust will become subject to the relevant property regime applicable to discretionary trusts. However, a TSI can still be created after such date at the death of the beneficiary. The Act provides for two instances. Firstly, where the IIP beneficiary is succeeded on death by his or her spouse or civil partner or where the underlying property constitutes a contract of life insurance. See ss 49D and 49E.

¹⁷² S 49(1A). The definition of "estate" in s 5 was furthermore amended to exclude interests in possession of which the beneficiaries became entitled on or after 22 March 2006, except for immediate post-death interests, disabled persons' interests and transitional serial interests. These last mentioned interests will still form part of the beneficiaries' estates.

¹⁷³ See Jarman (2006) Ch 5 for further reading.

interest in is principle excluded property.¹⁷⁴ There are exceptions to this rule, most of which were introduced to counter tax avoidance mechanisms. The exclusion is, for example, not applicable where a reversionary interest has been acquired for a consideration in money or money's worth,¹⁷⁵ where such an interest is an interest to which either the settlor or his spouse or civil partner is or has been beneficially entitled,¹⁷⁶ or where it constitutes an interest expectant on the termination of a lease for life (or a period ascertainable only by reference to a death).¹⁷⁷

8.6.3.4 Discretionary Trusts

The creation of a settlement in a non-interest in possession trust (usually a discretionary trust), whether by will or during lifetime, will usually be an immediately chargeable transfer for value.

The Act provides for a special regime in respect of "relevant property" settlements, which includes a 10-year anniversary charge and an exit charge. Effectively, the regime treats the trust as a separate entity. Relevant property refers in principle to property where there is no interest in possession.¹⁷⁸ In 2006 the definition of relevant property was amended to include most interests in possession (acquired on or after 22 March 2006 where the interest does not constitute an immediate post-death interest, a disabled person's interest and a transitional serial interest).¹⁷⁹ However, certain properties are excluded from the

¹⁷⁴ S 48(1).

¹⁷⁵ S 48(1)(a).

¹⁷⁶ S 48(1)(b). This provision applies to reversionary interests granted under settlements made after 16 April 1976 (s 48(2)).

¹⁷⁷ S 48(1)(c). See in general Tiley (2008) 1365–1367.

¹⁷⁸ S 58(1).

¹⁷⁹ S 58 (1A), (1B) and (1C). The revenue office (HMRC) stated that the new rules would apply to new trusts as well as additions to existing trusts. Whether the additions to existing trust would qualify as new settlements is, however, arguable. Chamberlain (2006) *Br Tax Rev* 628 submits that it is highly unlikely that the courts will determine that additions to existing trusts will be regarded as separate settlements in the light of the decision by the Court of Appeal in *IRC v Rysaffe Trustee Company (CI) Ltd* [2003] STC 536, in Footnote continues on the next page

concept of relevant property, such as property held for charitable purposes, property held for the purposes of a registered pension scheme, property comprised in a trade or professional compensation fund and property settled in maintenance funds for historic buildings, accumulation and maintenance trusts, trusts for bereaved minors and age 18-15 trusts.¹⁸⁰ The special fiscal regime applicable to some of these favoured trusts will be discussed in paragraph 8.6.3.5 below.

The 10-year anniversary charge (the “periodic charge”) arises on the tenth anniversary of the commencement of the settlement¹⁸¹ and then at the end of each subsequent 10-year period during the life of the settlement.¹⁸² The tax is calculated on the assumption that a chargeable transfer of value is made of the value of the relevant property held in trust immediately before the anniversary.¹⁸³ The amount of the transfer (together with all other chargeable transfers made by the transferor within the previous seven years) in excess of the nil rate band, will be subject to the periodic charge at a maximum rate of 30 percent of the lifetime rate, which is currently six percent (30 percent x 20 percent).¹⁸⁴ Both Whitehouse and Chamberlain mention that, although it has been claimed that a rate of six percent is far from penal, an increase in the rate to, for example, 10 percent would have the same effect as an annual wealth tax on trusts of one percent per year.¹⁸⁵

which it was held that the general law of trusts applies in establishing how many settlements there are and that the associated operations rules in s 268 cannot operate to reduce the number of separate settlements to one settlement. See also Wallington (2002) par E1.18.

¹⁸⁰ S 58.

¹⁸¹ A settlement is deemed to commence for the purposes of the Act on the date when property first became comprised in it. See s 61. It is sometimes difficult to establish whether an addition to an existing settlement constitutes a separate settlement or whether it forms part of the original settlement. See comment in n 179 above and Wallington (2002) par E3.12.

¹⁸² S 64.

¹⁸³ S 64.

¹⁸⁴ S 66.

¹⁸⁵ Whitehouse (2006) *Br Tax Rev* 209; Chamberlain (2006) *Br Tax Rev* 637.

The exit charge (also known as proportionate charge) arises, broadly speaking, where property ceases to be relevant property, for instance where it is distributed to a beneficiary.¹⁸⁶ A charge will however not arise where property is transferred out of the trust within three months of the commencement of the trust or following a 10-year anniversary.¹⁸⁷ The amount on which the tax is charged is the amount by which the value of the relevant property in the trust is decreased as a result of the event giving rise to the charge, reduced by the inheritance tax paid out of the relevant property.¹⁸⁸ The rate of charge is calculated in accordance with a complex set of rules. Where the chargeable event precedes the first 10-year anniversary charge, the rate of charge is a fraction of the rate that will be charged at the first 10-year anniversary.¹⁸⁹ However, where the chargeable event follows any anniversary charge, the rate of charge is a fraction of the rate that was charged at the last anniversary.¹⁹⁰ The fraction is calculated as a one-fortieth for each completed quarter (three months) which has passed since either the creation of the trust or the last 10-year anniversary. For example, where property is distributed two and a half years after the trust was created, the rate of charge will be calculated as 1.5 percent (10/40 of the full 10-yearly charge).¹⁹¹

8.6.3.5 Special Trusts

Since the incorporation of capital transfer tax in 1975, various types of trusts have been protected from the stringent rules applicable to relevant property settlements, the most prominent being the accumulation and maintenance trusts (A&M trusts). Special provision has since been incorporated for registered pension schemes, professional

¹⁸⁶ S 65(1). See Tiley (2008) 1378–1381 for example calculations of the exit charge. See also Wallington (2002) par E3.22.

¹⁸⁷ S 65(4).

¹⁸⁸ S 65(2).

¹⁸⁹ S 68.

¹⁹⁰ S 69.

¹⁹¹ See Tiley (2008) Ch 72 for further reading on the relevant property charges.

compensation funds, charitable trusts, pre-1978 protective trusts, employee benefit trusts, heritage property maintenance funds and bereaved minor trusts.¹⁹² However, the amendments to the Act in 2006 has effectively phased out any further future protection for A&M trusts.¹⁹³ With the exception of this radical change, the amendments to the provisions relating to the other favoured trusts were minimal.¹⁹⁴ A new category of age 18–25 trusts was also introduced. The following paragraphs provide a discussion of the protection afforded to the more prominent special trusts, namely the bereaved minor trust and the (new) 18-to-25 trust.

A bereaved minor trust, which can only be set up under a will (or by statutory provision in the case of intestacy) must benefit a minor child of the testator and must provide for the capital to vest at his or her 18th birthday.¹⁹⁵ Unlike A&M trusts there is no flexibility to select among the minor children. No 10-year anniversary and exit charges will be imposed on settlements in bereaved minor trusts. The acquisition of the property by the minor or the death of such minor before age 18 will furthermore not attract inheritance tax.¹⁹⁶

¹⁹² See Tiley (2008) Ch 73 and Jarman (2006) Ch 6, 7 for further reading.

¹⁹³ An A&M trust is a discretionary trust where the trust property was held or accumulated for the maintenance, education or benefit of beneficiaries until they reach the age of 25. The property settled in such a trust was not subject to the relevant property regime. As a consequence of the amendments affected to the Act in 2006, the protection will only continue to apply where the trustees have changed the terms of the trust before 6 April 2008 to provide that the beneficiaries would become absolutely entitled to the property on or before their 18th birthday. Trustees also had the option to transform the trust to an 18-to-25 trust (where the beneficiaries would become absolutely entitled to the property between their 18th and 25th birthdays), in which event any future distribution would become subject to the 18-to-25 exit charge. If nothing was done to change the terms of an existing A&M trust before 6 April 2008, the trust would have become a relevant property settlement on such date. See Jarman (2006) Ch 7. For criticism on the phasing out of this long-standing special regime, see Harper (2006) *Br Tax Rev* 395 *et seq.*

¹⁹⁴ See Jarman (2006) Ch 6 for further reading.

¹⁹⁵ S 71A.

¹⁹⁶ See Jarman (2006) 128–138 and Whitehouse (2008) *Private Client Business* 58–60.

A genre for age 18–25 trusts was introduced in 2006 in response to criticism that 18 is a very young age to take control and management of assets. Whereas the property has to vest before age 18 in the case of a bereaved minor trust, the 18–25 trust requires the trust capital to vest before age 25. Similar to a bereaved minor trust, the 18–25 trust will not be subject to the 10-year anniversary and exit charges whilst the beneficiary is under the age of 18. If the beneficiary dies after the age of 18 but before attaining 25, a special exit charge will be imposed (the maximum rate of charge will be 4,2 percent, namely $28/40 \times 6$ percent). This will also be the case where the trust ends after the beneficiary has attained the age of 18 or where it becomes held on relevant property regimes. There is no tax charged if a 10-year anniversary occurs during this period.¹⁹⁷

8.7 TREATMENT OF LIMITED INTERESTS AND BARE *DOMINIUM*

It is evident from the discussion in paragraph 8.6.3.1 above that the inheritance tax regime accommodates limited interests and bare *dominium* property under the settled property regime. The treatment of these interests is similar to the treatment of fixed interests under the IIP regime and differs depending on whether the limited interest was created before or after 22 March 2006.

8.7.1 The Position Prior to 22 March 2006

8.7.1.1 The Position of Bare Dominium

For the purposes of the pre-2006 regime the transfer of bare *dominium* (being regarded as a “reversionary interest”) is excluded from the tax base, but for a few exceptions to counter tax-avoidance (for example where the reversionary interest holder derives a

¹⁹⁷ S 71D. See Jarman (2006) 138–150 and Whitehouse (2008) *Private Client Business* 58–60 for further reading.

benefit from a transfer).¹⁹⁸ See example 1 below for an illustration. It should be evident that the deferral approach largely prevents taxpayers from concealing a passive transfer of property through passage of time.

8.7.1.2 The Creation of Limited Interests

The granting of a limited interest (for inadequate consideration) is regarded as a chargeable transfer, the value of which is determined equal to the value of the underlying property. No valuation concession is granted for the fact that the interest holder may only enjoy the interest for a certain period (whether the transfer occurs during lifetime or on death).

Example 1

- 1.1 On 1 March 2005 A (domiciled in the UK) donates a lifelong usufruct over his South African property worth £1 million to his son B. Ignoring any exemptions, PETS and rebates, A (the donor) will be liable for inheritance tax on the full value of the property (£1 million). When B (a domiciliary of the UK) dies 5 years later, his deceased estate will be liable for inheritance tax on the full value of the underlying property (say, £1.5 million) on the date of his death.
- 1.2 On 1 March 2005 A (domiciled in the UK) bequeaths South African property worth £1 million to his grandson C subject to a lifelong usufruct in favour of his son B. Ignoring any exemptions and rebates, A's deceased estate will (on A's death) be liable for inheritance tax on the property valued at £1 million. When B (a domiciliary of the UK) dies 5 years later, his deceased estate will be liable for inheritance tax on the full value of the underlying property (say, £1.5 million) on the date of his death.

In the case of successive interests, the position will be as follows:

Example 2:

A (domiciled in the UK) bequeaths bare *dominium* in South African property valued at €1 million to his son D subject to a lifelong usufruct in favour of B. A's will provides that, on B's death, C will be entitled to a lifelong successive interest in the property. Ignoring any exemptions and rebates, A's deceased estate will be liable for inheritance tax on €1 million. On the death of B (a UK domiciliary), B's deceased estate will

¹⁹⁸ See par 8.6.3.3.

become liable for inheritance tax on the full value of the underlying property (as valued on B's death). On the death of C (a UK domiciliary), C's deceased estate will become liable for inheritance tax on the full value of the underlying property (as valued on C's death).

8.7.1.3 *The Termination of Limited Interests*

The subsequent termination of a limited interest (through passage of time, on the death of an interest holder or upon renunciation) is treated as if the interest holder transfers the underlying property to the successive interest holder/the bare *dominium* owner. The transfer is regarded to occur between the interest holder and the successive interest holder/bare *dominium* owner (and not between the original owner and the successive interest holder/bare *dominium* owner).

One consequence of this approach is that any consideration paid for the bare *dominium* by the bare *dominium* owner to the original owner cannot be taken into consideration, as will more fully appear from the example below:

Example 3

A (domiciled in the UK) donates a usufruct over property worth £1 million to his son B and transfers the bare *dominium* in the property to his daughter C, who provides consideration to A for the bare *dominium* in the amount of £300 000. Ignoring any exemptions (including PETS) and rebates, A will in principle be liable for inheritance tax on the full value of the property (£1 million), notwithstanding the fact that he received consideration for the bare *dominium*. On the death of B (a UK domiciliary), B's deceased estate will be liable for inheritance tax on the full value of the underlying property. On the death of C (a UK domiciliary), C's deceased estate will be liable for inheritance tax on the full value of the underlying property.

8.7.2 **The Position After 22 March 2006**

Where the limited interest was created on or after 22 March 2006, the relevant property regime would, except for a few special cases, be applicable. Where, for example, a wealth holder grants a usufruct over property to a person, the granting of the usufruct would be treated as an immediately chargeable lifetime transfer. The "settlement" (meaning the property subject to the usufruct) would be liable for the periodic and exit charges. The

distribution of the property (on the termination of an interest) would not constitute a taxable event.

8.8 GENERAL ANTI-AVOIDANCE RULE

Although the Act does not contain a general anti-avoidance measure, the tax authorities may rely on the so-called “Ramsey principle”. This is a special anti-avoidance rule developed by the House of Lords, which provides that, where a preordained series of transactions or a single composite transaction, in which a step has been inserted with no commercial or family (non-tax) purpose, such an inserted step or steps may be ignored for the purposes of United Kingdom tax law.¹⁹⁹ However, commentators such as Hoffman plead that the courts should concentrate on construing statutes to give effect to the intention of parliament rather than develop general anti-avoidance principles.²⁰⁰

8.9 CAPITAL GAINS TAX

8.9.1 Capital Gains Tax Consequences

Since capital gains tax (CGT) was first introduced in the United Kingdom tax system in 1965, the making of a gift has been an occasion of charge.²⁰¹ The legislation currently in force, the Taxation of Chargeable Gains Act²⁰² (which replaced the original legislation in 1992), provides that, where a person disposes of an asset otherwise than by way of a

¹⁹⁹ The principle was established by the House of Lords in 1982 in the case of *Ramsey Ltd v IRC* [1982] AC 300 (HL). See also *Furniss v Dawson* [1984] AC 474.

²⁰⁰ Hoffman (2006) *Br Tax Rev* 197–206.

²⁰¹ Sandford, Willis and Ironside (1973) 96; Venables (1989) *Br Tax Rev* 335.

²⁰² Act 1992 c.12.

bargain made at arm's length, including (but not limited to) the making of a gift, the disposal will be deemed to be for a consideration equal to the market value of the asset.²⁰³

As pointed out in Chapter 3, a stepped-up base cost approach replaced the original deemed-realisation approach in 1971 and this approach was retained by the 1992 CGT legislation (which is still in force today).²⁰⁴ An heir acquires an asset from a deceased testator at a base cost equal to the market value of the asset at the testator's date of death, without any CGT consequences for the deceased estate.²⁰⁵ As pointed out earlier, the Mirrlees Review proposed that the stepped-up approach is unjustifiable and recommended that it should be replaced by a deemed realisation (or even a carry-over approach).²⁰⁶

Although it is beyond the scope of this study to examine the CGT consequences in relation to dispositions and distributions by trusts, a few comments are appropriate in light of the simultaneous operation of the settled property regime and because the 2006 changes in the inheritance tax settled property regime effected some changes to CGT as well.²⁰⁷ It must be stressed that these comments are broadly stated, and do not attempt to provide a detailed discussion. The overriding principle is that a trust is treated for the purposes of the United Kingdom tax system as a separate independent entity.²⁰⁸ A transfer to a trust constitutes a disposal by the transferor for the purposes of CGT.²⁰⁹ Any subsequent disposal of assets by trustees will generally be treated along the same lines as

²⁰³ Taxation of Chargeable Gains Act s 17(1). See in general Wallington (2002) par C6.11.

²⁰⁴ See Ch 3 par 3.2.3 n 38 and accompanying text.

²⁰⁵ Taxation of Chargeable Gains Act 1992 s 62. See in general Wallington (2002) par D5.11.

²⁰⁶ Boadway, Chamberlain and Emmerson: Mirrlees Review (2008) 3. See also Ch 3 par 3.2.4.

²⁰⁷ See Mckie (2006) *Br Tax Rev* 212 *et seq* for a brief explanation of the changes effected to the CGT regime applicable to trusts.

²⁰⁸ Taxation of Chargeable Gains Act s 69(1).

²⁰⁹ Taxation of Chargeable Gains Act s 70.

disposals by individuals. Where trustees distribute property to a beneficiary, the trustees are deemed to have disposed of and reacquired the property at the market value thereof.²¹⁰ The trustees will therefore in general be liable for CGT on any capital gain that arises as a result of the deemed disposal.²¹¹

Prior to the amendments in 2006, it was provided that, where a beneficiary became absolutely entitled to property as a result of the death of a person entitled to an interest in possession in the settlement, no chargeable gain accrued on the disposal. Instead, the base cost was stepped up to the market value of the property at the date of the death of the life tenant.²¹² In addition, where the interest in possession terminated on the death of the life tenant and the property in which it subsisted continued to be settled property (and did not accrue to another beneficiary absolutely) then the trustees were deemed to dispose of and reacquire the property at the market value on the date of death of the beneficiary, without any taxable disposition accruing.²¹³ The effect of this was that the base cost was stepped up on the date of death of the life tenant and any unrealised capital gains were left untaxed.²¹⁴ These concessions were included to put a person receiving assets on the death of a life tenant (or the trustees where the property remains settled) in the same position as a person receiving assets on the death of an absolute owner (where the stepped-up approach is followed).²¹⁵ However, the 2006 changes reduced the operation of these concessions to immediate post-death interests, transitional serial interests and bereaved minor interests.²¹⁶ McKie points out that the 2006 changes have nonetheless created a

²¹⁰ Taxation of Chargeable Gains Act s 71.

²¹¹ McKie (2006) *Br Tax Rev* 214.

²¹² Taxation of Chargeable Gains Act s 73. See also McKie (2006) *Br Tax Rev* 214.

²¹³ Taxation of Chargeable Gains Act s 72.

²¹⁴ McKie (2006) *Br Tax Rev* 215.

²¹⁵ McKie (2006) *Br Tax Rev* 214.

²¹⁶ McKie (2006) *Br Tax Rev* 214–215. The writer mentions (at 215–216) that it is deeply anomalous that a disabled person's interest has been left out of these "privileged interests", especially in view of the fact that Footnote continues on the next page

considerable disadvantage of trust ownership compared to absolute ownership.²¹⁷ He mentions that the 2006 changes to inheritance tax and CGT were introduced as part of a project to modernise the income tax, capital gains and inheritance tax treatment of trusts, but concludes that the attempted harmonisation has failed. He argues that “there was absolutely no reason why the changes to inheritance taxation should have resulted in changes to capital gains tax”.²¹⁸

8.9.2 Interaction with Inheritance Tax

Any liability for capital gains tax in respect of a transfer (such as in the case of a gift), will, if borne by the transferor, not be deductible in calculating the value of the transfer. Hold-over relief is, however, usually available in respect of the capital gains tax (for example where property is settled in a discretionary trust during the lifetime of the settlor) or where a distribution is made from a trust (subject to the relevant property regime).²¹⁹ Where the capital gains tax is borne by the transferee, it will constitute an allowable deduction.²²⁰

8.10 CONCLUSIONS

- (a) In the United Kingdom the taxation of wealth transfers is currently accommodated in a single statute under the Inheritance Tax Act.²²¹

a disabled person’s interest remains to be treated under the old IIP regime for the purposes of inheritance tax.

²¹⁷ McKie (2006) *Br Tax Rev* 217.

²¹⁸ McKie (2006) *Br Tax Rev* 213.

²¹⁹ In terms of Taxation of Chargeable Gains Act s 260. See in general Wallington (2002) par G6.13 and McKie (2006) *Br Tax Rev* 213.

²²⁰ S 165.

²²¹ See par 8.1.1 n 5 and accompanying text.



- (b) The Act nonetheless levies a wealth transfer tax (called “inheritance tax”) by virtue of separate charging provisions for “lifetime transfers” and “transfers on death”.²²²
- (c) Despite the separate charging provisions, the rules pertaining to the jurisdictional basis and the ordinary valuation rules (as discussed in paragraph 8.3) apply equally to lifetime transfers and transfers on death.²²³ Because of the fact that the scope of United Kingdom wealth transfer tax regimes (with the exception of the short-lived capital transfer tax regime) has had a limited application to lifetime transfers, a number of the double taxation agreements entered into since the introduction of estate duty cover transfers on death only. The unilateral relief provisions apply, however, to both lifetime transfers and transfers on death, eliminating to a large extent any inequities arising as a result of the limited application of the double taxation agreements to lifetime transfers.²²⁴
- (d) The preferential valuation regimes for business property and agricultural property apply to all transfers, whether they occur during lifetime or on death. There are, however, special rules in place where a transfer on death occurs within a seven-year PET period.²²⁵
- (e) The roll-over relief for non-agricultural woodlands applies exclusively to transfers on death.²²⁶

²²² See pars 8.2.1 and 8.2.2.

²²³ See pars 8.2.3 and 8.3.

²²⁴ See par 8.2.4.

²²⁵ See par 8.5.2.

²²⁶ See par 8.5.4.

- (f) In the area of exemptions, the Act distinguishes between exemptions applicable to both lifetime transfers and transfers on death; exemptions applicable to lifetime transfers only and exemptions applicable to transfers on death only. The majority of the exemptions fall into the first category (where the exemptions apply to both types of transfers). The most prominent difference between lifetime transfers and transfers on death is the PET regime, which applies to lifetime transfers only. The Mirrlees Review has, however, identified the PET regime, where lifetime transfers may escape tax indefinitely, as a major drawback for horizontal equity between transfers that occur during lifetime and transfers that occur on death. Moreover, it was shown that the PET regime has resulted in the relevant property regime (applicable to discretionary trusts) being adopted for IIP trusts as well. For the rest of the exemptions, differentiation is usually justifiable (for example, the annual gift exemption for lifetime transfers).²²⁷
- (g) The different rates for lifetime transfers (taxed at 20 percent) and transfers on death (taxed at 40 percent) as well as the credit system (where inheritance tax paid on lifetime transfers is credited against the tax payable on death) seems complicated and an administrative burden to the system. It also disturbs the horizontal equity between transfers that occur during lifetime and transfers that occur during death.²²⁸
- (h) Although recipient-based duties were levied in the United Kingdom (together with transferor-based duties) prior to 1949, the system levied only transferor-based wealth transfer taxation thereafter in the form of estate duty, which was replaced by capital transfer tax in 1975 and which

²²⁷ See par 8.5.3 and par 8.6.2 n 151 and accompanying text.

²²⁸ See par 8.1.2.

was in turn replaced by inheritance tax in 1986 (which is currently still in force).²²⁹ The inheritance tax regime resembles a typical example of a transferor-based wealth transfer tax. However, the system contains some elements which are characteristic of recipient-based taxation, such as the exemption of a transfer to a spouse.²³⁰ The paragraphs below will highlight some characteristics and problem areas (similar to the areas identified under the South African wealth transfer tax system in Chapter 7).²³¹

- (i) For the purposes of lifetime transfers, the complications surrounding an intention to donate have been circumvented by the elimination of such a requirement. However, *bona fide* commercial transactions are sheltered from the tax base by virtue of a specific exemption. Although the impoverishment of the transferor is implicit, a corresponding enrichment by another person is not required under the primary charging provision for lifetime transfers (although some form of enrichment is required where a loss is experienced under a failure to exercise a right). This position creates some strange results. The focus of a wealth transfer tax, even if levied on the transferor, should be on the *transfer* of the wealth, which presupposes some form of enrichment for a recipient. It seems therefore as if the characteristics statutorily required for a lifetime transfer are not satisfactory.²³²
- (j) The problem experienced in the area of value-shifting arrangements (in that the disposer company is not impoverished) is overcome in the inheritance tax regime by provisions attributing the arrangements to the

²²⁹ See par 8.1.1.

²³⁰ See par 8.5.3.1.

²³¹ See Ch 7 par 7.4.

²³² See par 8.2.1.

participators of the close company. The existing shareholders are therefore regarded as the transferors of the benefits granted to the incoming shareholder.²³³

- (k) Over and above ordinary lifetime transfers, benefits indirectly “transferred” by virtue of a *failure to exercise a right* (an omission) are specifically included in the tax base, thereby extending the scope of the tax to e.g. the failure of a person to claim a performance.²³⁴

- (l) Although the provision that “changes in the value of the estate” as a result of the person’s death should be taken into account ensures that life insurance benefits payable to the deceased estate are subject to inheritance tax, benefits payable to a nominated beneficiary (a recipient) escape taxation, arguably because the tax is levied from the perspective of the transferor (the deceased estate).²³⁵ It is, however, unclear why the Act does not contain any provisions deeming such benefits to be a taxable transfer.

- (m) Although the concepts of a usufruct, *fideicommissum* and bare *dominium* property are foreign to United Kingdom property law, these interests are treated under the settled property regime for the purposes of inheritance tax. Usufructuary interests, fideicommissary interests and annuities charged on property are treated as “fixed (life) interests” and bare *dominium* property and fiduciary interests are treated as “reversionary interests”.²³⁶ Depending on whether the limited interest was first created

²³³ See par 8.2.1.

²³⁴ See par 8.2.1.

²³⁵ See par 8.2.2.

²³⁶ See par 8.6.3.1.

before or after 22 March 2006, the pre-2006 IIP regime or the relevant property regime will be applicable.

- (n) In the case of the pre-2006 regime, the initial granting of a limited interest constitutes a lifetime transfer, but the transfer of bare *dominium* property is (but for a few exceptions) deferred until it materialises into full ownership.²³⁷
- (o) As a consequence, taxpayers are largely prevented from concealing a passive transfer of property through passage of time under the pre-2006 regime.²³⁸
- (p) In the event where the granting of the limited interest is immediately taxable (under the pre-2006 regime), inheritance tax will be levied on the full value of the underlying property and no concession will be granted, because a fixed interest is not valued with reference to actuarial tables.²³⁹ This is understandable if one considers that inheritance tax is levied from the perspective of the transferor, where the focus of the tax is on what is “given away”. The no-concession approach may, however, be justifiable in a United Kingdom context where the holder of a fixed life interest is legally regarded as the “beneficial owner” of the underlying property, especially if one considers that such an interest is usually freely disposable.²⁴⁰

²³⁷ See par 8.7.1.1.

²³⁸ See par 8.7.1.1.

²³⁹ See par 8.7.1.2.

²⁴⁰ See par 8.6.1.

- (q) The death or renunciation of an interest holder does not pose any significant difficulties for the system because such an event merely accelerates another transfer.²⁴¹
- (r) A problem that arises as a result of the fact that the interest holder (under the pre-2006 regime) is regarded as the transferor of the property on the materialisation of the bare *dominium* into full ownership (and not the original owner) is that any consideration received by the original owner for the bare *dominium* property would not have been taken into consideration in the calculation of his or her inheritance tax liability.²⁴²
- (s) Where a limited interest is granted on or after 22 March 2006, the relevant property regime applicable to discretionary trusts (referred to below) will usually be applicable and the usufructuary will be liable for periodic levies and an exit charge.²⁴³
- (t) It is evident from the historical development of wealth transfer taxation in the United Kingdom that discretionary trusts have posed some challenging issues for the system. Although the initial transfer to a discretionary trust would fall within the scope of the inheritance tax base, the problem is that any further tax may indefinitely be deferred where the interests remain contingent. To counter tax-avoidance through discretionary trusts, the legislature introduced a “relevant property regime”, which basically personified trusts by making the trustees liable for periodic charges and exit charges.²⁴⁴

²⁴¹ See par 8.7.1.3.

²⁴² See par 8.7.1.3.

²⁴³ See par 8.7.2.

²⁴⁴ See par 8.6.

- (u) Some of the major complications of the relevant property charges are the harmonisation of the regime (which is operated on a transferor basis) with the capital gains tax system. Although the United Kingdom operates a stepped-up base-cost approach for transfers on death (which eliminates the problem of double taxation in the case of transfers on death), the stepped-up approach does not usually apply to the transfer of interests in trust property (since the amendments effected in 2006). Double taxation is also produced when property is distributed to beneficiaries. It would seem that the United Kingdom has not been successful in harmonising the interaction between the inheritance tax regime and the capital gains tax system in the realm of trusts.²⁴⁵
- (v) The inheritance tax regime presents an example of a wealth transfer tax system where substantial relief is afforded to business property in the form of remittance of the tax liability. Some commentators have questioned the foundational justification of the relief.²⁴⁶
- (w) To overcome the problem common to transferor-based taxation – namely, that the tax liability is usually taken into consideration in the valuation of the property taxable in a deceased estate, whereas gifts are usually not valued taking the tax liabilities into account – the Act provides that the inheritance tax liability of a transferor may be taken into consideration in all transfers (whether they occur during lifetime or on death).²⁴⁷

The next chapter will review wealth transfer taxation in the Netherlands.

²⁴⁵ See par 8.9.

²⁴⁶ See par 8.5.2.

²⁴⁷ See par 8.5.1.

CHAPTER 9
WEALTH TRANSFER TAXATION
IN THE NETHERLANDS

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9.1 HISTORICAL ORIENTATION AND INTRODUCTION

9.1.1 Historical Development

Succession duties were first introduced in some of the provinces of the Netherlands at the end of the sixteenth century.¹ Following the proclamation of the Batavian Republic at the end of the eighteenth century, the *Ordonnantie eener Belasting op het Regt van Successie* was introduced in 1805, in terms of which a transferor-based estate duty was levied.² This Act was temporarily replaced with the French *Frimairewet* in 1812,³ whereafter the first *Successiewet* of 1817 was introduced,⁴ which levied inheritance tax (*successierecht*) in a similar way as was provided for by the Ordinance of 1805.⁵ The tax was later extended to the transfer of Dutch property that belonged to foreigners, namely transfer tax (*recht van overgang*).⁶

The *Successiewet* of 1859 reintroduced some key elements of a recipient-based tax.⁷ Van Vijfeijken explains that this occurrence has unfolded parallel to the development of the idea that a person should ideally be taxed in accordance with his or her taxable capacity.⁸ The tax base was extended to the taxation of gifts (*schenkingsrecht*) in 1917.⁹ The need to

¹ See Ch 3 par 3.2.3.

² Adriani (1925) 5–6; Schuttevaer and Zwemmer (1998) v5; Zwemmer (2001) *Mededelingen* 9; Van Vijfeijken (2002) *WPNR* 179; Dijkstra (2008) *WPNR* 445; Sonneveldt and De Kroon (2008) *WFR* 594.

³ From 1810 to 1813 the Netherlands was part of the French Empire.

⁴ Schuttevaer and Zwemmer (1998) v5; Zwemmer (2001) *Mededelingen* 10; Dijkstra (2008) *WPNR* 446.

⁵ Adriani (1925) 28.

⁶ Adriani (1925) 30.

⁷ VanVijfeijken (2002) *WPNR* 179; Sonneveldt and De Kroon (2008) *WFR* 594.

⁸ Van Vijfeijken (2004) *WPNR* 321.

⁹ Adriani (1925) 32; Zwemmer (2001) *Mededelingen* 10.

reform the legislation developed in 1947,¹⁰ which culminated in the introduction of the *Successiewet* of 1956 (Inheritance and Gifts Tax Act, hereafter referred to as “the Act”),¹¹ which is primarily based on the character of the 1859 Act¹² and which is (in its amended form) still in force today.

In view of the fact that the current system is based on early nineteenth-century legislation, various efforts have been made to modernise the Act.¹³ In 2000, a commission appointed by the Minister of Finance under the chairmanship of Moltmaker issued a report on the modernisation of the tax titled *De Warme, De Koude en De Dode Hand* (hereafter “Moltmaker Report”).¹⁴ The report, having accepted the justification and recipient-based structure of the tax,¹⁵ focused mainly on the treatment of family transfers, the acquisition of enterprises and trusts and foundations. Although the government agreed with most of the committee’s recommendations,¹⁶ only a few amendments to the Act were effected, apparently due to budgetary constraints.¹⁷

In 2008 the Minister of Finance announced that the existing legislation, being old, complicated and prone to tax avoidance, was to be replaced by new legislation, namely

¹⁰ Schuttevaer and Zwemmer (1998) v6.

¹¹ Act of 28 June 1956, introduced on 1 August 1956.

¹² Van Vijfeijken (2002) *WPNR* 179.

¹³ E.g. in 1964 a new Act was proposed, but this proposal was never implemented. See Schuttevaer and Zwemmer (1998) v6. See also Martens and Sonneveldt (2007) 1–3 for a short exposition of the changes effected in 1980, 1984, 1997, 2000, 2001, 2002, 2005, 2006 and 2007. See also Auerbach (2008) *WFR* 1080.

¹⁴ The title refers to a Dutch expression for making gifts with the warm hand, the passing of property by the deceased with the cold hand and the transfer of assets to a trust or foundation with the dead hand. See Sonneveldt in Sonneveldt *ed* (2002) 52 n 18.

¹⁵ Moltmaker Report (2000) 7.

¹⁶ See Van Vijfeijken (2001) *WFR* 1381–1390 for a comprehensive discussion on the proposals that were lodged in the second chamber of parliament.

¹⁷ De Waard in Sonneveldt *ed* (2002) 11; Van Vijfeijken (2002) *WPNR* 187 (for a brief summary of the amendments).

De Wet Schenk- en Erfbelasting.¹⁸ As a consequence, numerous scholars published their comments and proposals in anticipation of the new regime.¹⁹ However, in view of the extensive research that a new fiscal regime would have required, the legislature instead opted for the route of introducing comprehensive amendments to the existing Act. On 20 April 2009, the Minister of Finance submitted to the Second Chamber of Parliament the “Legislative Proposal for the Amendment of the Inheritance and Gift Tax Act” (*Wetsvoorstel Wijziging Successiewet*),²⁰ containing proposals for the amendment of the existing Act in respect of various matters. The proposed amendments elicited a tidal wave of criticism by Dutch scholars and tax advisers.²¹ Following a process of parliamentary debates and amendments,²² an amended legislative proposal (hereafter referred to as “31 930 A”)²³ was submitted to the First Chamber of Parliament, which was accepted on 15 December 2009 and became effective on 1 January 2010. The general sentiment in academic circles is nonetheless that the amendments are, overall, disappointing and incomplete.²⁴

¹⁸ The Minister made this announcement on 14 April 2008. See *Gastcollege Staatssecretaris van Financien*, a presentation delivered at Tilburg University, available at <http://www.schenkenerfbelasting.nl> (accessed on 1 March 2009). For a summary of the address, see Van Bommel and De Pagter (2008) *WFR* 501 *et seq* and Boer (2008) *WFR* 518 *et seq*.

¹⁹ See collection of articles that have since been published in e.g. *Weekblad Fiscaal Recht (WFR)* and *Weekblad Privaatrecht, Notariaat en Registratie (WPNR)*, some of which will be referred to in the paragraphs below. See also the information available at www.schenkenerfbelasting.nl.

²⁰ *Kamerstukken* 31930, available at http://www.tweedekamer.nl/kamerstukken/aanhangige_wetgeving/index.jsp (accessed on 22 May 2009). For the Minister’s comments and brief summary of the proposals, see http://www.minfin.nl/Actueel/Kamerstukken/2009/04/Legislative_wijziging_Successiewet (accessed on 22 May 2009).

²¹ Dijkstra (2009) *WFR* 896 *et seq* refers to a congress held by the Dutch Federation of Tax Advisers on the topic in June 2009.

²² See the parliamentary debates, reports and amendments available at <http://parlando.sdu.nl>.

²³ 31 930 A, available at <http://parlando.sdu.nl>.

²⁴ See e.g. Van Vijfeijken (2009) *WPNR* 528; Sonneveldt and De Kroon (2009) *WFR* 737.

9.1.2 Broad Overview of Inheritance Tax and Gift Tax

Inheritance tax (*erfbelasting*)²⁵ is primarily levied on the value of everything acquired by a person by virtue of an inheritance from a person with *woonplaats*²⁶ in the Netherlands.²⁷ In addition, gift tax (*schenkbelasting*)²⁸ is levied on property acquired by a person under a gift from a donor with *woonplaats* in the Netherlands.²⁹ Broadly speaking, these charges are levied on the net amount acquired by a beneficiary. The taxable value is in general determined by deducting from the value of the property the debts and charges incurred by the beneficiaries. The Act provides for a broad spectrum of relief and exemptions, some of which depend on the relationship between the transferor and the beneficiary.

Prior to the amendments affected on 1 January 2010, transfer tax (*recht van overgang*) was also levied on the value of certain properties located in the Netherlands (*binnenlandse situsgoederen*),³⁰ which were acquired by a person by virtue of an

²⁵ The traditional term *successierecht* was replaced with the term *erfbelasting* on 1 January 2010. See 31 930 A. For criticism on the new term, see Van Vijfeijken (2009) *WPNR* 520.

²⁶ Although the Act does not define the concept, it provides that a legal entity will be regarded as having *woonplaats* in the Netherlands if it has been established in the country (s 2.2). This will in general be determined with reference to its place of effective management. See Sonneveldt, Bom and Zuiderwijk (1995) 32 and Van Vijfeijken in Kolkman *et al* (2006) 637–638. However, the General Code on Taxes of 1994 (*Algemene Wet Inzake Rijksbelastingen*) s 4 provides that the fiscal *woonplaats* of a natural person should be determined according to his or her circumstances, which could, for example, be determined with reference to the location of his or her primary residence, the place where his or her children attend school, the period of time spent abroad, his or her nationality and the location of his or her business or labour agreement. See Soares and McCutcheon (1995) 96; Sonneveldt, Bom and Zuiderwijk (1995) 31–32; Martens and Sonneveldt (2007) 6–7. *Woonplaats* is therefore determined with reference to the daily life of the person, which is not identical to the general concept of domicile, which usually depends on the subjective intention of a person, or the Anglo-American concept of residency. See Soares and McCutcheon (1995) 96 and Sonneveldt Doctoral Thesis (2000) 151.

²⁷ S 1.1° (as amended by 31 930 A).

²⁸ The traditional term *recht van schenking* was replaced with the term *schenkbelasting* on 1 January 2010. See 31 930 A.

²⁹ S 1.2° (as amended by 31 930 A).

³⁰ *Binnenlandse situsgoederen* included *inter alia* (a) business assets attributable to a permanent establishment, including property rights to such an enterprise other than the rights of the shareholder, (b) immovable property situated in the Netherlands or rights *in rem* in respect of such property, not forming part of an enterprise and (c) profit-sharing rights with regard to an enterprise with its effective management in the Netherlands, unless the rights originate from employment or are in the form of securities. See ss

Footnote continues on the next page

inheritance or a gift from a testator or donor with *woonplaats* outside the Netherlands.³¹ For the purposes of transfer tax, the allowable deductions were restricted to certain inland debts (*binnenlandse schulden*)³² only.³³ In addition, the exemptions offered in the realm of transfer tax were extremely limited.³⁴ In view of these restrictions, the question was raised at numerous occasions whether or not transfer tax was compatible with European Union law.³⁵ The debate was intensified in view of the European Court's ruling that the restriction on the deductibility of debts was too narrow for the purposes of the free movement of people and capital in the European Union.³⁶ Numerous commentators therefore suggested that transfer tax, being hardly justifiable and easily avoidable, should be repealed or replaced by some or other alternative.³⁷ It is therefore not surprising that transfer tax was totally repealed from the Act by the 2010 amendments. In reaction,

5.3.a, 5.3.b.1°, 5.5 and 5.3.b.2° (prior to the amendments effected by 31 930 A in 2010). See in general Sonneveldt, Bom and Zuiderwijk (1995) 30; Van Vijfeijken in Kolkman *et al* (2006) 643 and Martens and Sonneveldt (2007) 79.

³¹ S 1.1.2° (as it read before the amendments effected in terms of 31 930 A).

³² *Binnenlandse schulden* included (a) debt claims attributable to a Dutch permanent establishment, and (b) debts in respect of immovable property situated in the Netherlands, secured by mortgage and incurred in respect of the acquisition, improvement or maintenance of such immovable property. See s 5.4 (as it read before the amendments effected in terms of 31 930 A in 2010). See in general Sonneveldt, Bom and Zuiderwijk (1995) 30; Van Vijfeijken in Kolkman *et al* (2006) 643–644 and Martens and Sonneveldt (2007) 79–80.

³³ S 5.2 (as it read before the amendments effected in terms of 31 930 A). Also, inland debts incurred within one year prior to the date of death or the date of the gift were disregarded. See in general Van Vijfeijken in Kolkman *et al* (2006) 674 and Martens and Sonneveldt (2007) 147.

³⁴ See s 32a.1–3 (as it read before the amendments introduced by 31 930 A on 1 January 2010).

³⁵ In an attempt to resolve the difficulties, the Moltmaker Report (2000) 64 recommended the return of the pre-1985 regime, levying a proportional transfer tax at a rate of 6% with no provision for the deduction of liabilities and charges. This proposal was never implemented. See De Haan and Idsinga (2002) *WFR* 724–735 and Van Vijfeijken (2002) *WPNR* 186–187 for further reading.

³⁶ See Van Vijfeijken (2004) *WPNR* 631 *et seq* and Martens and Sonneveldt (2007) 81–83 for a discussion of the Barbier case. This decision has influenced the European Court in a number of subsequent cases, such as the cases of Gerritse, Jager, Eckelkamp and Arens-Sikken. See Van Vijfeijken (2009) *WFR* 341–346 for a discussion on the cases of Arens-Sikken and Eckelkamp.

³⁷ See Van Vijfeijken (2004) *WPNR* 328; Van Vijfeijken (2008) *WPNR* 305–306; Zwemmer (2008) *WPNR* 422; Van Vijfeijken (2008) *WPNR* 428–429; Sonneveldt and Monteiro (2008) *WPNR* 430–433; Sonneveldt and De Kroon (2008) *WFR* 596–597; Van Vijfeijken (2009) *WFR* 346.

Sonneveldt and De Kroon concede that this move is understandable, especially considering that transfer tax contributed a mere €6 million to national revenue. However, they question whether the total lack of taxation in respect of non-residents is truly what the legislature had in mind, especially considering that inheritances and gifts are usually exempt from the property transfer tax.³⁸

Since the inception of the Act in 1956, the applicable tax rate has depended on the relationship between the transferor and the beneficiary as well as the size of the acquisition. Prior to the amendments of 2010, provision was made for three different rate categories, namely (a) group 1, applicable to a surviving spouse, registered partner or a qualifying cohabitant,³⁹ children, grandchildren and other descendants of the transferor, (b) group 2, applicable to brothers and sisters, parents, grandparents, great-grandparents and other ascendants of the transferor and (c) group 3, applicable to all other beneficiaries (“strangers”).⁴⁰ The 2010 amendments simplified the categories (as well as the rate structures). In addition, a new concept for a “partner” was introduced, which now includes a spouse, registered partner and, subject to certain conditions, a cohabitant.⁴¹ For the 2010 year of assessment, the rate categories and rate structures are as follows:

- For partners and children: 10 percent on the first €118 000 together with a charge of 20 percent on the amount above the threshold;
- For grandchildren: 18 percent on the first €118 000 together with a charge of 36 percent on the amount above the threshold; and

³⁸ Sonneveldt and De Kroon (2009) *WFR* 737. Note, however, that these authors do not purport to suggest that the property transfer tax should be used as a measure to substitute the lack of taxation in respect of inheritances and gifts made by non-residents. For a critical discussion on the effect of the 2010 amendments to the property transfer tax regime, see Boer, Lubben and Schuver-Bravenboer (2009) *WFR* 745 *et seq.*

³⁹ The Act provided for a contractual cohabitant, a two-party non-contractual cohabitant and a multiple party non-contractual cohabitant. See s 24.2(a)–(c) (as it read before the amendments effected by 31 930 A in 2010). See Van Vijfeijken in Kolkman *et al* (2006) 701–702, 703 and Martens and Sonneveldt (2007) 201 for further reading on the classification of these cohabitants.

⁴⁰ S 24.1 and 24.2 (as it read before the amendments effected in terms of 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 700.

⁴¹ S 1a (as amended by 31 930 A).

- For all other persons: 30 percent on the first €118 000 together with a charge of 40 percent on the amount above the threshold.⁴²

Because taxpayers may be tempted to “split” acquisitions to attract a more favourable tax position, the Act provides that, where two partners have acquired inheritances or gifts from the same testator or donor, the tax will be calculated as if it had been one aggregated acquisition. In the case where there is a difference in relationship, the closest relationship will be indicative.⁴³ Furthermore, gifts made by the same donor to the same donee are aggregated within one calendar year.⁴⁴ All the gifts by parents to children are also aggregated per calendar year.⁴⁵

9.2 TAX BASE

The Act provides for acquisitions by virtue of gifts and inheritances. In addition, certain arrangements and events are deemed to be a gift or an inheritance, depending on the circumstances. These fictions are referred to as “fictitious acquisitions” and will be discussed in paragraph 9.2.3 below.

9.2.1 Acquisitions by virtue of Gifts

Gift tax is primarily levied on the value of a gift acquired by any person (whether an individual or a legal entity).⁴⁶ The tax is levied on the donee⁴⁷ upon the conclusion of the

⁴² S 24 (as amended by 31 930 A).

⁴³ S 25 (for inheritances) and s 26 (for gifts).

⁴⁴ S 27. See in general Van Vijfeijken in Kolkman *et al* (2006) 707 and Martens and Sonneveldt (2007) 195.

⁴⁵ S 28. See Van Vijfeijken in Kolkman *et al* (2006) 707 and Martens and Sonneveldt (2007) 195.

⁴⁶ S 1.2° (as amended by 31 930 A).

⁴⁷ S 36.

gift, after the fulfillment of any suspensive conditions.⁴⁸ A gift includes a formal gift (*schenking*) as well as a material gift (*gift*).⁴⁹ A formal gift is an agreement in terms of which the donee is enriched at the expense of the donor. The four essential elements are (a) an agreement; (b) an intention of generosity on the part of the donor (*oogmerk van liberaliteit*); (c) the impoverishment of the donor and (d) the enrichment of the donee.⁵⁰ A formal gift, for example, includes an agreement in terms of which property is donated without the obligation to reward the donor and the waiver of a debt.⁵¹ A material gift (which is a wider concept) includes *any act*, except for a formal gift, whereby one person enriches another at his or her own expense, provided that the act will only constitute a gift once the beneficiary has received the right to claim the donated property.⁵² Although the concept of a material gift is wider than a formal gift, the elements of enrichment, impoverishment and the intention of generosity (hereafter the “gift characteristics”) are still required.⁵³ Examples of material gifts are remuneratory gifts⁵⁴ and the sale of property for a price less than market value (with the corresponding intention of generosity).⁵⁵ However, an ordinary *bona fide* commercial transaction below market value will not constitute a material gift.⁵⁶ To counter the difficulties involved in the burden of proof that relates to the intention of generosity, Van Rijn has proposed that a

⁴⁸ S 1.9 (as amended by 31 930A).

⁴⁹ S 1.7 (as amended by 31 930 A).

⁵⁰ See Van Vijfeijken in Kolkman *et al* (2006) 629–630 and Martens and Sonneveldt (2007) 53–60 for a detailed discussion on the elements of a formal gift (*schenking*), as required in terms of the Civil Code 7:175.

⁵¹ See Van Vijfeijken in Kolkman *et al* (2006) 630–636 and Martens and Sonneveldt (2007) 55–72 for various examples and scenarios.

⁵² Martens and Sonneveldt (2007) 59 refers to Civil Code 7:187.

⁵³ Van Vijfeijken in Kolkman *et al* (2006) 629.

⁵⁴ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁵⁵ Martens and Sonneveldt (2007) 59.

⁵⁶ Van Vijfeijken in Kolkman *et al* (2006) 629.

provision should be included in the Act whereby the intention of generosity is deemed to be present in gifts from family members, unless proven otherwise.⁵⁷

An omission (*een niet handelen*) may also in principle constitute a gift.⁵⁸ However, the gift requirements must still be complied with. The mere failure to exercise a right will therefore not constitute a gift where the person (who failed to exercise the right) has not in actual fact been impoverished by the omission. According to Van Vijfeijken, it will not always be simple to establish whether the requirements are complied with in the event of an omission.⁵⁹

The Act specifically provides that any benefit accruing as a result of a repudiation of an inheritance will not constitute a benefit accruing under a gift.⁶⁰ The amount of tax levied on the substituted heir will, however, not be less than it would have been had the original heir not repudiated.⁶¹ In the case where a surviving spouse parts with the *wettelijke verdeling* as provided for in section 18 of book 4 of the Civil Code, the inheritance tax liability will be established as if the *wettelijke verdeling* was cancelled retrospectively.⁶²

9.2.2 Acquisitions by virtue of Inheritance

Inheritance tax is primarily levied on the value of property acquired by a person (an individual or a legal entity) by virtue of an inheritance.⁶³ An acquisition by virtue of an

⁵⁷ Van Rijn (2008) *WPNR* 437.

⁵⁸ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁵⁹ Van Vijfeijken in Kolkman *et al* (2006) 630.

⁶⁰ S 1.8 (as amended by 31 930 A). In the case where a surviving spouse parts with the *wettelijke verdeling* as provided for in section 18 of book 4 of the Civil Code, the inheritance tax liability will be established as if the *wettelijke verdeling* was cancelled retrospectively. See in general Martens and Sonneveldt (2007) 60.

⁶¹ S 30.

⁶² S 1.8.

⁶³ S 1.1° (as amended by 31 930 A).

inheritance includes acquisitions through testamentary dispositions as well as statutory regulations.⁶⁴

The tax is imposed on the heir at the moment of the death of the testator.⁶⁵ Where an inheritance is subject to a suspensive condition, the remaining heirs would have to pay inheritance tax on the value of the property comprised in the inheritance subject to the condition. The heirs would basically keep the inheritance in pledge for the conditional heir. On the fulfilment of the condition, the heirs may claim the inheritance tax previously paid by them from the tax authorities.⁶⁶

9.2.3 Fictitious Acquisitions

The Act deems certain acquisitions or third party arrangements to be either a gift or an inheritance. In view of the fact that the fictions have developed over many years into a complicated set of rules, some of which are even based on the principles of historic transferor-based (estate) taxation,⁶⁷ the Moltmaker Report and commentators from academic circles have over the years called for the modernisation of these provisions.⁶⁸ Furthermore, some scholars have pleaded that the fictions approach is archaic and too narrow and have proposed that the chargeable events should be redefined to link up instead with a broader concept of an economic acquisition.⁶⁹ In spite of these proposals, the basic character of all the existing fictions have remained intact following the 2010 amendments, although various changes have been effected to the provisions to counter

⁶⁴ As provided for in the Civil Code Book 4. See Van Vijfeijken in Kolkman *et al* (2006) 626 and Martens and Sonneveldt (2007) 19.

⁶⁵ S 36.

⁶⁶ S 53(1).

⁶⁷ Van Vijfeijken (2002) *WPNR* 179–180 and 183–185 refers to the fictions provided for ss 10 and 15 (prior to its amendment in 2003).

⁶⁸ Moltmaker Report (2000) 51–60 (the provisions were never implemented); Verstraeten (2000) *WPNR* 614; Van Vijfeijken (2002) *WPNR* 179–180; Zwemmer (2008) *WPNR* 423.

⁶⁹ See e.g. Van Rijn (2008) *WPNR* 438–439 and Schols (2009) *WPNR* 485.

some anti-*fiscus* judgments, eliminate some avoidance loopholes and re-structure the existing fictions. The amendments also introduced some additional fictions (mentioned in paragraphs (d), (i)(b) and (l) below). However, Van Vijfeijken mentions that the amendments have also created some new issues, and expresses regret over the fact that the legislature did not use the window of opportunity to modernise and simplify the fictions regime.⁷⁰

For the acquisitions listed in paragraphs (b), (c), (e), (f), (g), (i)(b) and (j) below, the value of the acquisition may be reduced by any amount that was paid by the beneficiary for the respective benefit acquired by him or her, together with simple interest calculated at a statutory rate (currently six percent) from the date of the payment to the date of the deemed acquisition.⁷¹ Also, any gift tax (relating to the event under the fiction) that was payable at an earlier stage together with simple interest calculated at a statutory rate (currently six percent) from the date of the payment to the date of the deemed acquisition will in general be deductible from the amount inheritance tax payable.⁷²

The Act currently provides for the following fictions:

- (a) Where the deceased's heirs renounce their share in the communal estate, the surviving spouse (who was married in community of property with the deceased) will be regarded as having acquired the renounced matrimonial rights by virtue of an inheritance.⁷³

⁷⁰ Van Vijfeijken (2009) *WFR* 722. See also Schols (2009) *WPNR* 484.

⁷¹ S 7.1 and 7.3 (as amended by 31 930 A). Prior to the 2010 amendments, this concession was limited to the s 10 fiction only. See s 10.3 (as it read prior to the amendments effected by 31 930 A).

⁷² S 7.2 and 7.3 (as amended by 31 930 A) read with s 12.2 (as amended). Prior to the 2010 amendments, this concession was limited to the s 10 fiction only. See s 10.4 (as it read prior to the amendments effected by 31 930 A).

⁷³ S 6. See in general Van Vijfeijken in Kolkman *et al* (2006) 645 and Martens and Sonneveldt (2007) 89–90. S 30 provides that the amount inheritance tax payable will not be lessened by any renunciation of rights. The amount payable by the surviving spouse will therefore not be less than the amount that would have been payable should the community of property not have been renounced.

- (b) Where the deceased labelled goods in his or her possession, excluding registered goods, as belonging to another person, the beneficiary will, subject to certain exceptions,⁷⁴ be regarded as having acquired the goods by virtue of an inheritance from the deceased.⁷⁵
- (c) Where someone has admitted to an obligation in his or her will, the value of such an obligation will be regarded as having been acquired by the beneficiary by virtue of an inheritance on the death of the first-mentioned person.⁷⁶
- (d) With effect from 1 January 2010, where a monetary claim which was acquired under an inheritance (*onderbedelingsvorderingen*) becomes claimable or is settled and such a claim includes interest at a higher rate than the prescribed statutory rate (currently six percent), then the amount of interest in excess of the statutorily calculated interest will be deemed to be an inheritance by the creditor from the debtor.⁷⁷
- (e) Subject to certain exceptions and conditions, the so-called “section 10 fiction” provides that where a deceased had (during his or her life) transferred an asset by virtue of a legal act (*rechtshandeling*) or any associated acts (*samenstel van rechtshandelingen*)⁷⁸ of which he or she or his or her partner had been a party, to a

⁷⁴ Exceptions are provided for (a) where the deceased was in possession of such goods in the course of his enterprise or profession (excluding goods “belonging” to close relatives and their partners), (b) where the deceased was in possession of the goods by reason of an official position such as an executor, curator, guardian or similar position, (c) goods in the possession of one of the co-owners, (d) goods belonging to the surviving partner and (e) where the claim for the goods already existed during the lifetime of the deceased. See s 8.4 (as amended by 31 930 A).

⁷⁵ S 8.1.

⁷⁶ S 8.3 (as amended by 31 930 A). Prior to the amendments, this fiction was provided for in s 9. See in general Van Vijfeijken in Kolkman *et al* (2006) 649–652 and Martens and Sonneveldt (2007) 101–105 for the position prior to the 2010 amendments.

⁷⁷ S 9.2 (as amended by 31 930 A).

⁷⁸ The meaning of *rechtshandeling* has been the subject of debate. Some are of the opinion that it is restricted to an agreement, while others argue for a wide interpretation, namely any act with legal

Footnote continues on the next page

partner or close relative at the expense of such transferor's estate and subject to the reservation of a lifelong enjoyment of the asset (such as a usufruct or periodic payment) in favour of himself or herself, then the acquisition by the beneficiary of the *full ownership* upon the death of the deceased transferor (or within 180 days prior to the death) will be deemed to have been acquired by such beneficiary by virtue of an inheritance.⁷⁹ The value of the deemed inheritance will be the full value of the property on the death of the transferor less any consideration paid for the *bare dominium* property (sacrificed by the *bare dominium* owner) plus interest at six percent.⁸⁰ Where B did not provide any consideration, but was liable for gift tax on the initial acquisition of the *bare dominium* property, the gift tax will be credited against any inheritance tax due.

The fiction in its current form (as described above) had been broadened by the 2010 amendments. Prior to 1 January 2010, the section did not refer to associated acts (*samenstel van rechtshandelingen*) and was restricted to cases where only the testator was a party to the *rechtshandeling*. The application of section 10 (prior to the 2010 amendments) created a number of uncertainties and interpretation problems, for example in the area of *onderbedelingsvorderingen*. The section was also relatively easy to circumvent. For example, the fiction did not extend to the so-called *gesplitste aankoop*, where, for instance, A purchases a usufruct and B (A's son) purchases the *bare dominium* from C. It was also common for a wealth holder to sell the *bare dominium* in property to a close relative and to stay on

consequences. Apparently the judiciary favours the latter approach. See Van Vijfeijken in Kolkman *et al* (2006) 654 and Van Vijfeijken (2009) *WFR* 713–714. See also Schols (2009) *WPNR* 487–488. With effect from 1 January 2010, certain acts have been expressly excluded from the ambit of *rechtshandeling*. See s 10.7 (as amended by 31 930 A).

⁷⁹ S 10.1 read with 10.4 (as amended by 31 930 A).

⁸⁰ S 7.

residing in the property at a nominal lease payment.⁸¹ However, the 2010 amendments introduced some measures countering these tax avoidance techniques.⁸² Provisions were also introduced to exclude the operation of the fiction to *onderbedelingsvorderingen* and certain other scenarios.⁸³ Because this fiction is especially relevant in the realm of limited interests for comparative purposes, it will more fully be explained (with the assistance of examples) in paragraph 9.7 below.

- (f) Where a partner or close relative (or his or her partner) acquires more than his or her rightful share in partnership property during the life of a former partner or as a result of the death of such partner, any excess share shall be regarded as having been acquired by virtue of a gift or an inheritance respectively.⁸⁴ Also, where a person acquires, on the death of a spouse, more than his or her rightful share in communal property by virtue of the provisions of an ante-nuptial contract or a distribution agreement, the award in excess of his or her rightful share will be deemed to have been acquired by him or her by virtue of an inheritance.⁸⁵
- (g) Where someone renounces a debt in favour of another person, provided that such person survives him or her, then the value of such a renounced debt shall be

⁸¹ For further reading on the tax avoidance opportunities prior to the 2010 amendments, see Van Vijfeijken (1997) *WFR* 11–21; Blokland, Klinkert-Cino and Schutte (1998) Ch 5 67–80; Vegter (2003) *WPNR* 421 *et seq*; Van Vijfeijken in Kolkman *et al* (2006) 653–658 and Martens and Sonneveldt (2007) 105–125.

⁸² S 10.1 and 10.3.

⁸³ S 10.5–10.7.

⁸⁴ S 11.1 and 11.2 (as amended by 31 930 A). Prior to the amendments, the Act referred only to the acquisition of partnership property (in excess of a rightful share) on the *death* of a former partner. The fiction has therefore been extended to lifetime transfers. For the position prior to the amendments, see in general Van Vijfeijken (2002) *WPNR* 185–186; Van Vijfeijken in Kolkman *et al* (2006) 658–662 and Martens and Sonneveldt (2007) 92–98.

⁸⁵ S 11.4 (as amended by 31 930 A). Prior to the amendments, this fiction was separately provided for in s 7. For further reading on the pre-2010 text, see Van Vijfeijken in Kolkman *et al* (2006) 646–647 and Martens and Sonneveldt (2007) 92. For further reading on the amendments to the fiction, see Van Vijfeijken (2009) *WFR* 719–720 and Schols (2009) *WPNR* 486–487.

- regarded as having been acquired by the beneficiary by virtue of an inheritance on the death of the first-mentioned person.⁸⁶
- (h) Any gift made within a period of 180 days prior to the death of a donor with *woonplaats* in the Netherlands will be regarded as having been acquired by the donee by virtue of an inheritance.⁸⁷ With effect from 1 January 2010, property acquired under a gift, which is only completed after the death of the donor, will also be regarded as having been acquired by virtue of an inheritance.⁸⁸
- (i)(a) The benefits acquired through a life insurance agreement⁸⁹ are regarded as having been acquired by the beneficiary thereof by virtue of an inheritance from the deceased estate of the life insured, “to the extent that” the deceased contributed to the acquisition of the policy benefits, provided that such beneficiary was not already liable for gift tax or inheritance tax in respect of the surrender value of the policy at an earlier stage.⁹⁰ Where a deceased insured, for example, paid 80 percent of the premiums in respect of a life policy and the beneficiary paid 20 percent, then only 80 percent of the benefits payable on the insured’s death will be taxable in the hands of the beneficiary. A life policy that was affected by a company or partnership on the life of one of the members will typically not fall within the ambit of the Act in view of the fact that the company or partnership

⁸⁶ S 11.3 (as amended by 31 930 A). Prior to the amendments, this fiction was provided for in s 9.

⁸⁷ S 12.1 (first full sentence). The content of this section was not affected by the 2010 amendments. For further reading, see Van Vijfeijken in Kolkman *et al* (2006) 662–663; Martens and Sonneveldt (2007) 125–127 and Van Vijfeijken (2009) *WFR* 722.

⁸⁸ S 12.1(second full sentence). This sentence was added by 31 930 A and is effective from 1 January 2010.

⁸⁹ According to Dutch law, the benefits acquired by a beneficiary in terms of a life insurance policy upon the death of the insured life are enforceable in their own right and not through the estate or the deceased estate of the policy owner, who is in many instances also the insured life. See Van Vijfeijken in Kolkman *et al* (2006) 664.

⁹⁰ S 13.1 (as amended by 31 930 A).

will normally have been responsible for the payment of the premiums.⁹¹ Prior to the 2010 amendments, the fiction applied to all cases where the insured contributed “something” to the acquisition of the benefits and the full value of the benefits was in principle subject to inheritance tax. However, the Act included a provision (which was repealed by the 2010 amendments) stating that anything sacrificed by the beneficiary in respect of the acquisition of the policy benefits, such as premiums, were deductible from the value of the benefits.⁹² The amendments effected in 2010, which have limited the scope of the fiction, have generally been welcomed by scholars as more equitable.⁹³

- (i)(b) With effect from 1 January 2010 an additional provision was included stating that, where the insurer (*verzekeraar*) of a life policy is a partner or close relative (or his or her partner) of the deceased insured (*verzekerde*), then the full value of the policy benefits are deemed to have been acquired by virtue of an inheritance from the insured.⁹⁴
- (j) Where a partner or a close relative (or his or her partner) of a person is the holder of a substantial share in an enterprise, as defined in the Income Tax Act of 2001, in respect of which the value has been increased as a consequence of the last-mentioned person’s death, then the value of the shareholding, less any related

⁹¹ See in general Van Vijfeijken in Kolkman *et al* (2006) 664–669 and Martens and Sonneveldt (2007) 128–142.

⁹² S 23.1 (as it read before the amendments effected by 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 695–697.

⁹³ See e.g. Van Vijfeijken (2009) *WFR* 717–718.

⁹⁴ S 13(2) (as introduced in terms of 31 930 A). For further reading, see Van Vijfeijken (2009) *WFR* 718–719.

- debts or deferred income tax liabilities,⁹⁵ will be deemed to have been acquired by virtue of an inheritance.⁹⁶
- (k) Where a person unilaterally renounces a limited interest, the expansion of another person's beneficial interest in the property will be regarded as a fictitious acquisition by the last-mentioned person from the first-mentioned person.⁹⁷
- (l) With effect from 1 January 2010, the absence of market-related interest on a demand loan is regarded as a gift to the debtor by the creditor of a usufruct over the money on a daily basis chargeable on an annual basis, provided that the loan had been awarded to an individual by another individual not in the ordinary course of his or her profession or trade.⁹⁸ This method was earlier proposed by the Moltmaker Report.⁹⁹ The fiction need not have been extended to term loans, because the nominal value of a term loan is less than the market value of the claim for repayment (in the absence of market-related interest). The difference in these values constitutes the gift of a usufruct over the money in terms of the ordinary rules.¹⁰⁰

⁹⁵ See par 9.9 for description of deferred income tax liabilities.

⁹⁶ S 13a (as amended by 31 930 A) for the pre-2010 text, see Van Vijfeijken in Kolkman *et al* (2006) 670–673 and Martens and Sonneveldt (2007) 142–143. For further reading on issues related to the 2010 amendments, see Van Vijfeijken (2009) *WFR* 723.

⁹⁷ S 14.

⁹⁸ S 15 (as amended by 31 930 A). The amount of the interest foregone could not qualify as a gift in terms of the ordinary rules. The impoverishment of the donor seems to be the problematic issue, in view of the fact that no proprietary rights have indeed been abandoned by the lender. See Van Vijfeijken in Kolkman *et al* (2006) 631 and Martens and Sonneveldt (2007) 61. For further reading on the 2010 amendments, see Van Vijfeijken (2009) *WFR* 721 and Schols (2009) *WPNR* 494–495.

⁹⁹ Moltmaker Report (2000) 65. See also Zwemmer (2008) *WPNR* 423.

¹⁰⁰ The definition of a usufruct includes the free use of property. See par 9.3.4. If there is no date determined for the repayment of the money, the usufruct will be valued over the life expectancy of the debtor. See Van Vijfeijken in Kolkman *et al* (2006) 631–632 and Martens and Sonneveldt (2007) 60–64.

9.2.4 Jurisdictional Basis

The jurisdictional basis of the respective taxes is determined with reference to either *woonplaats* or the location of assets.

9.2.4.1 Residency (*Woonplaats*)

Inheritance tax and gift tax is in principle chargeable where the transferor has his or her *woonplaats* in the Netherlands at the date of his or her death or on the conclusion of the gift.¹⁰¹ Although the legal structure of the Act is based on a recipient-based tax, the *woonplaats* of the beneficiary is actually irrelevant.¹⁰² This position has been evaluated and questioned by some commentators. The Moltmaker Report supported the connection with the *woonplaats* of the transferor, in view of the fact that a connection with the recipient ranks under a connection with the transferor for the awarding of the primary right to tax under the OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts (1982). Also, a connection with the transferor is globally speaking much more popular.¹⁰³ Some scholars argue, however, that the beneficiary's

¹⁰¹ S 1.1° and 1.2°. Since the enactment of the Ordinance of 1805, the charge for Dutch wealth transfer taxes (charged in various forms under various fiscal regimes) have been based on the principle of *woonplaats*. This tendency is in line with the general trend that has been followed in most other European jurisdictions. See Adriani (1925) 10; Van Vijfeijken (2002) *WPNR* 179; Sonneveldt (2004) *WPNR* 315; Sonneveldt and De Kroon (2008) *WFR* 594. In view of the fact that the *woonplaats* of a person can be changed at an instant, the Act provides for a few fictions (*woonplaatsficties*), which deem the *woonplaats* of the transferor to be within the Netherlands in certain circumstances. The “ten-year rule” (provided for in s 3.1) creates the fiction that any person with Dutch nationality who had a *woonplaats* in the Netherlands and who has died or donated property within ten years from the date on which the person obtained a *woonplaats* outside the Netherlands, will be regarded as having *woonplaats* within the Netherlands at the date of his or her death or upon the making of a gift. The “one-year rule” (as provided for in s 3.2) deems a person who has had a *woonplaats* within the Netherlands and who donated property within one year after having obtained a *woonplaats* outside the Netherlands to have a *woonplaats* within the Netherlands upon the making of a gift. S 2 (as amended by 31 930 A) also provides that a Dutch citizen, residing outside the Netherlands and who is in the employment of the government as a diplomatic representative, together with his or her partner and children younger than 27 years, are regarded as having their *woonplaats* in the Netherlands. For further reading on the fictions, see Soares and McCutcheon (1995) 98; Sonneveldt, Bom and Zuiderwijk (1995) 32–33; Sonneveldt (2004) *WPNR* 318–319; Van Vijfeijken (2004) *WPNR* 327; Meussen (2004) *WPNR* 639 *et seq*; Van Vijfeijken in Kolkman *et al* (2006) 638–639 and Martens and Sonneveldt (2007) 7–13.

¹⁰² Sonneveldt, Bom and Zuiderwijk (1995) 31; Van Vijfeijken in Kolkman *et al* (2006) 626.

¹⁰³ Moltmaker Report (2000) 7. For support of this proposal, see Zwemmer (2001) *Mededelingen* 26.

woonplaats should ideally be the connecting factor, in view of the fact that the legal structure has evolved from a transferor-based tax to a recipient-based tax.¹⁰⁴ Van Vijfeijken explains that the two main objections against such an approach are (a) the administrative difficulties that would be created for the tax authorities (to deal with foreign assets) and (b) the fact that the connection with the transferor is, globally speaking, the most popular approach. A regime where the connection is restricted to the recipient would therefore either contribute to double taxation or a lack of taxation.¹⁰⁵ She nevertheless points out that many European jurisdictions, such as Germany, Finland, France and Austria, have initiated “double connecting factors” by levying wealth transfer taxation with reference to the *woonplaats* of both the transferor and the recipient. Although she concedes that this approach is objectionable, she submits that it could serve as a transitional measure towards the eventual connection to the *woonplaats* of the recipient.¹⁰⁶ Sonneveldt and Monteiro call for the connection to be directed at the *woonplaats* of the recipient only. They argue that the international preference is not such a great obstacle, especially in view of the fact that the Netherlands has only entered into a few tax treaties with other countries. They mention that an adjustment to the jurisdictional basis would in actual fact encourage negotiations in respect of treaties with countries such as Belgium, France and Germany.¹⁰⁷ Another scholar, Van der Weerd-Van Joolingen, also concluded that the international difficulties related to a recipient-connection are not insurmountable.¹⁰⁸ Although the Minister of Finance has indicated that

¹⁰⁴ Van Vijfeijken (2002) *WPNR* 180; Van Vijfeijken (2004) *WPNR* 320; Van Vijfeijken (2008) *WPNR* 425; Sonneveldt and Monteiro (2008) *WPNR* 434; Van Rijn (2008) *WPNR* 437; Juch (2008) *WFR* 656; Sonneveldt and De Kroon (2008) *WFR* 596.

¹⁰⁵ Van Vijfeijken (2008) *WPNR* 425. This author also refers to the fact that the *woonplaats* of the transferor takes preference to the *woonplaats* of the recipient in terms of the OECD model convention on estate and inheritance taxation.

¹⁰⁶ Van Vijfeijken (2002) *WPNR* 180 and Van Vijfeijken (2004) *WPNR* 327.

¹⁰⁷ Sonneveldt and Monteiro (2008) *WPNR* 434–435. See also Sonneveldt and De Kroon (2008) *WFR* 596.

¹⁰⁸ Van der Weerd-Van Joolingen (2009) *WFR* 833.

the extension of the connection to the *woonplaats* of the recipient should be considered,¹⁰⁹ the jurisdictional basis has not been altered by the 2010 amendments.

9.2.4.2 Location of Assets

As explained above, the location of certain assets in the Netherlands acquired under an inheritance or a gift from a person with *woonplaats* outside the Netherlands had previously been included in the jurisdictional basis of the Act through the levying of transfer tax (*recht van overgang*) on such acquisitions.¹¹⁰ However, transfer tax was abolished with effect from 1 January 2010.¹¹¹

9.2.5 Double Taxation

Relief for double taxation can be afforded through double taxation agreements or through the granting of a unilateral tax credit.¹¹²

Double taxation agreements have been entered into with Switzerland, Sweden, Finland, the United States of America, Israel, Great Britain and Northern Ireland, and Austria (although the agreements with Sweden, Israel and Austria are of limited effect because wealth transfer taxes have been abolished in those countries). With the exception of the agreements concluded with Great Britain and Northern Ireland and Austria (which covers inheritance tax and gift tax), the agreements apply to inheritance tax only. The multilateral ruling (*Belastingregeling voor het Koninkrijk* or “BRK”) with the other

¹⁰⁹ JK de Jager, address of 14 April 2008 at the University of Tilburg, available at www.schenkenerfbelasting.nl (accessed on 15 May 2009).

¹¹⁰ See par 9.1.2.

¹¹¹ See 31 930 A.

¹¹² See in general Martens and Sonneveldt (2007) Ch 9.

member countries of the Kingdom of the Netherlands applies to both inheritance tax and gift tax.¹¹³

The Order for the Prevention of Double Taxation (*Besluit Voorkoming Dubbele Belasting*)¹¹⁴ provides that, where a person with *woonplaats* in the Netherlands is liable for inheritance tax or gift tax in respect of property situated in a foreign jurisdiction, then that person would be entitled to unilateral relief under the order in the absence of relief granted by a double taxation agreement.¹¹⁵ In terms of the relief, a credit is granted for the foreign inheritance tax (or gift tax) or the proportionate part of the Dutch inheritance tax (or gift tax), whichever is the lower, attributable to assets which form part of a permanent establishment in that foreign country, or in respect of immovable property situated in that country.¹¹⁶ In respect of all other assets situated in the foreign jurisdiction (e.g cash), the taxpayer would be entitled to claim the foreign tax as a liability in the valuation of the asset for the purposes of Dutch inheritance tax.¹¹⁷ These reliefs also operate in respect of gift tax.¹¹⁸

9.2.6 Object of Taxation: Property

The object of taxation is the value of all that is acquired (*die waarde van al wat wordt verkregen*),¹¹⁹ which includes tangible as well as intangible property.¹²⁰

¹¹³ See in general Martens and Sonneveldt (2007) 233–234.

¹¹⁴ This order (“BVDB”) was issued in 2001 under s 38 of the General Tax Code.

¹¹⁵ BVDB ss 1–2.

¹¹⁶ BVDB s 47. See Martens and Sonneveldt (2007) 235–236 for some examples.

¹¹⁷ BVDB s 49.

¹¹⁸ BVDB s 51.

¹¹⁹ S 1.1° and 1.2°.

¹²⁰ Martens and Sonneveldt (2007) 20 refer to Civil Code 3:1.

9.3 VALUATION

Except for a general rule, the Act provides special provisions for the valuation of residential property, usufructs and annuities, bare *dominium*, listed shares and businesses. Provision is also made for favourable valuation rules in respect of business property and qualified country estates, rules that are more fully discussed in paragraph 9.5.2 below.

Property should be valued on the moment of its acquisition,¹²¹ which is, in the case of an inheritance, generally the date of death of the testator, and in the case of a gift, the date that the agreement has been concluded.¹²²

9.3.1 General Rule

If no special rule applies, property is assessed at its fair market value.¹²³

9.3.2 Residential Property

With effect from 1 January 2010, the so-called WOZ value has been made applicable for the valuation of residential property for the purposes of both inheritance tax and gift tax.¹²⁴ The WOZ value of residential properties is periodically assessed by the relevant municipalities pursuant to the Valuation of Immovable Property Act (*Wet Waardering Onroerende Zaken*). The values are stored in a central administration system, which is accessible for the purposes of the valuation of property for tax or insurance purposes. In terms of the new provisions introduced in the Act, the WOZ values for the year preceding the relevant tax year would, subject to certain exceptions, be used for valuation

¹²¹ S 21.1.

¹²² Van Vijfeijken in Kolkman *et al* (2006) 686.

¹²³ S 21.1. See Van Vijfeijken in Kolkman *et al* (2006) 687 and Martens and Sonneveldt (2007) 153 for further reading.

¹²⁴ S 21.5 – 21.9 (as amended by 31 930 A).

purposes.¹²⁵ Because WOZ values do not account for the depreciatory effect caused by lease agreements, special regulations were issued to provide for a discount in these instances.¹²⁶ A special rule is also provided for properties subject to hereditary tenures.¹²⁷

9.3.3 Periodic Payments (Annuities)

A “periodic payment”, meaning not only a payment in money, but any recurrent or fixed performance,¹²⁸ is valued by multiplying the annual value¹²⁹ of the payments with a predetermined factor (published under an implementation decree (*uitvoeringsbesluit*) as an annexure to the Act) that relates either to the age and life expectancy of the beneficiary, or to a fixed period of time.¹³⁰ Special rules apply where the payments relate to more than one person’s life expectancy. Where the payments expire at the death of the survivor of these persons, then the factor will be determined according to the age of a

¹²⁵ S 21.5 and 21.7.

¹²⁶ S 21.8 read with UB Ch 1 s 10a.

¹²⁷ S 21.9.

¹²⁸ S 18.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 677.

¹²⁹ If the amount of the periodic payment is uncertain, for instance where a person becomes entitled to an annual profit share, the annual value must be estimated (Implementation Decree (*Uitvoeringsbesluit* or “UB”) Ch 1 s 8.1). If the payment is not in money, then the value of the performance should be used (UB Ch 1 s 8.2).

¹³⁰ S 21.13 (as amended by 31 930 A) and UB Ch 1 ss 5–7. Where the payments are payable for the duration of a single person’s life, the factor varies between 16 (for a person younger than 20 years) to 2 (for a person older than 90 years)(UB 7A s 5). Where the payments are payable for a fixed period of time, the relevant factor depends on whether or not the period is restricted to the beneficiary’s life expectancy. Where the period is restricted as such, a specific factor is determined for (1) the first 5 years, (2) the period 5–10 years, (3) the period 10–15 years (4) the period 15–20 years (5) the period 20–25 years and (6) any further period exceeding 25 years. For each of these periods, the factor depends on whether the beneficiary is (a) younger than 40 years, (b) between 40 and 60 years or (c) older than 60 years. The factor varies between 0.84 (for a person younger than 40 years), 0.83 (for a person 40–60 years) and 0.75 (for a person older than 60 years) in respect of the first 5 years to 0.12 (for a person younger than 40 years), 0.06 (for a person 40–60 years) and zero (for a person older than 60 years) in respect of the period that exceeds 25 years. Where the payments are payable for a fixed period of time (unrestricted by a person’s life expectancy), the factor varies between 0.85 for the first 5 years to 0.15 for the period that exceeds 25 years (UB 7A s 6.1). If the beneficiary of the periodic payments passes away prior to the expiration of the period, the payments in respect of the unexpired period devolve upon such person’s heirs, who will once again be liable for the payment of inheritance tax in respect of the remaining period. See in general Martens and Sonneveldt (2007) 161–164.

person five years younger than the youngest of them.¹³¹ Where the payments expire at the death of the first of them to die, then the factor will be determined according to the age of a person five years older than the oldest of them.¹³² Special provision is also made for the enjoyment of payments for an undetermined period of time.¹³³

Where a periodic payment is subject to a resolutive condition, for instance the remarriage of a person, the calculation is made irrespective of the condition. Upon the condition being fulfilled, the periodic payment may be re-valued and any excess inheritance tax may be reclaimed on application to the tax authorities.¹³⁴

9.3.4 Usufructs

For the purposes of the Act a usufruct¹³⁵ includes the use of an asset without adequate consideration, a right of habitation (*habitatio*) and distributions in the form of income, fruit or allowances charged against property.¹³⁶ A usufructuary interest is valued by multiplying its annual value, calculated at six percent¹³⁷ of the fair market value of the underlying property, with the relevant factor, which is determined in the same manner as

¹³¹ UB 7A s 7.1.

¹³² UB Ch 1 s 7.2.

¹³³ UB Ch 1 s 6.3 (the factor would be set at 17). This would for instance be the case where a periodic payment is bequeathed to a foundation (*stichting*) for the period of its existence. See Martens and Sonneveldt (2007) 163.

¹³⁴ S 53. See in general Van Vijfeijken in Kolkman *et al* (2006) 763; Martens and Sonneveldt (2007) 162.

¹³⁵ The Dutch civil code describes a usufruct as a “limited right which gives a right to use [of] property belonging to another and to enjoy the fruits thereof”. See Sonneveldt, Bom and Zuiderwijk (1995) 45.

¹³⁶ S 18.1. See in general Van Vijfeijken in Kolkman *et al* (2006) 677 and Martens and Sonneveldt (2007) 165.

¹³⁷ Zwemmer argues that the six percent rule is old-fashioned and in need of reform. The fixed percentage can either be exploited where the actual yield is higher than six percent, or it can function unfairly where the yield is lower than six percent. See Zwemmer (2008) *WPNR* 423.

provided for in respect of the valuation of periodic payments.¹³⁸ The usufruct must be valued at the moment that the usufructuary becomes entitled to the enjoyment thereof.¹³⁹ See paragraph 9.7 below for example calculations.

9.3.5 Bare *Dominium*

The value of bare *dominium* property is calculated as the difference between the fair market value of the underlying property and the value of the usufruct.¹⁴⁰ In the case of successive usufructs, the value of the bare *dominium* is calculated as if a usufruct was granted for the duration of a joint continuance of lives (until the death of the survivor), which means that the usufruct would be calculated in accordance with the factor established with reference to the age of a person five years younger than the youngest of the usufructuaries.¹⁴¹ See paragraph 9.7 below for example calculations.

9.3.6 Fideicommissum (*Tweetrapsmaking*)

The legal construction of a *fideicommissum* is that the first beneficiary (in Latin the *fiduciarius*, in Dutch the *bezwaarde erfgenaam*) inherits the property subject to a resolutive condition, whereas the second beneficiary (in Latin the *fideicommissarius*, in Dutch the *verwachter*) acquires the property subject to a suspensive condition.¹⁴² For the purposes of the valuation of the property in the hands of the first beneficiary, the Act

¹³⁸ S 21.13 read with UB Ch 1 s 10. See Blokland, Klinkert-Cino and Schutte (1998) 81–81, 86–93 for a discussion and examples. The health of the usufructuary and market interest are irrelevant factors. See Van Vijfeijken in Kolkman *et al* (2006) 766. See also Martens and Sonneveldt (2007) 165–166 (for an example).

¹³⁹ Van Vijfeijken in Kolkman *et al* (2006) 691.

¹⁴⁰ S 21.10.

¹⁴¹ See par 9.3.3.

¹⁴² Van Vijfeijken in Kolkman *et al* (2006) 690; Martens and Sonneveldt (2007) 155. For the construction of a *fideicommissum* under South African law, see Ch 5 par 5.2.4 n 45.

provides that the resolutive and suspensive conditions should be disregarded.¹⁴³ The market value of the asset will therefore be assessed as if no condition to preserve the property had been imposed. The second beneficiary will be deemed to have acquired the property from the testator (*insteller*) on the death of the first beneficiary,¹⁴⁴ which means that the blood relationship between the testator and the second beneficiary will be relevant for the determination of the applicable tax rate.¹⁴⁵

9.3.7 Businesses

A business (sole proprietorship) or partnership interest is valued with reference to the price a third party with the intention of continuing the enterprise would be willing to pay for it (referred to as the “going concern value”).¹⁴⁶ It is also provided that the going concern value (for the purposes of the Act) should at least be the liquidation value (which may be lower or higher than the going concern value).¹⁴⁷

The acquisition of business property may, however, be subject to business relief (as will be discussed more fully below), which is determined with reference to the going concern value. However, where the liquidation value is higher than the true going concern value, the tax attributable to the difference in the values may also be subject to business relief (subject to the business being continued for a period of five years after the acquisition).¹⁴⁸

¹⁴³ S 21.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 690.

¹⁴⁴ S 21.4 (as amended by 31 930 A).

¹⁴⁵ Sonneveldt, Bom and Zuiderwijk (1995) 42.

¹⁴⁶ S 21.12 (as amended by 31 930 A). For further reading on the different valuation methods, see Van Vijfeijken in Kolkman *et al* (2006) 688–689; Martens and Sonneveldt (2007) 173–176 (also for example calculations); Sonneveldt in Sonneveldt *ed* (2002) 52.

¹⁴⁷ S 21.12.

¹⁴⁸ See par 9.5.2.1.

9.3.8 Listed Shares

Listed shares are valued according to their published closing price on the date preceding the day of acquisition.¹⁴⁹

9.4 TAXPAYER AND FILING OF RETURN

Inheritance tax and gift tax are primarily levied on the beneficiary of an inheritance or gift.¹⁵⁰ The taxes are collected in terms of an assessment system.¹⁵¹ In the case of inheritance tax, a taxpayer must file a tax return within a period of eight months from the death of the wealth holder.¹⁵² In the case of gift tax, the return must be submitted within two months from the end of the calendar year in which the liability for the tax had been incurred.¹⁵³ Subsequent to the filing of the tax return(s), the revenue authorities will then issue assessments. Where there are a number of heirs benefiting from the same estate, they are entitled to submit a joint return.¹⁵⁴ An executor may also complete returns on behalf of the heirs, unless all the heirs reside outside the Netherlands, in which case the executor is obliged to submit the returns on their behalf.¹⁵⁵

9.5 RELIEF MECHANISMS

The Act provides for various forms of relief, which include (a) the deduction of certain liabilities and any consideration paid from the value of a gift or inheritance, (b) the

¹⁴⁹ S 21.3. Unlisted shares are valued according to the general rule. See Van Vijfeijken in Kolkman *et al* (2006) 690.

¹⁵⁰ S 36.

¹⁵¹ S 37. For further reading, see Martens and Sonneveldt (2007) 241–247.

¹⁵² S 45.

¹⁵³ S 46.

¹⁵⁴ S 39.

¹⁵⁵ S 72.

provision of preferential valuation rules in respect of business property and qualified country estates and (c) the provision of certain exemptions.

9.5.1 Allowable Deductions: Liabilities and Consideration

For the purposes of inheritance tax, the charge is levied on the value of all that is acquired by the beneficiary, less the beneficiary's share in any debts, legacies and charges deductible in terms of the Act.¹⁵⁶ The debts must be due and payable at the moment of death.¹⁵⁷ An heir burdened with the obligation to adhere to a legacy or a personal charge would therefore be able to deduct the value of such a charge from his or her inheritance.¹⁵⁸

Specific provision is made for the deductibility of reasonable funeral costs¹⁵⁹ as well as certain deferred income tax liabilities.¹⁶⁰ Administration costs, executor's fees, valuation costs and inheritance tax are not deductible, in view of the fact that they were not due and payable upon the death of the testator and in the absence of any specific provision in this regard.¹⁶¹

For the purposes of gift tax, all debts and obligations relating to the gift, in terms of which either the donor or a third party would have benefited, are deductible from the value of the property comprised in the gift.¹⁶²

¹⁵⁶ S 5.1 read with s 20. See in general Van Vijfeijken in Kolkman *et al* (2006) 642 and Martens and Sonneveldt (2007) 21–24.

¹⁵⁷ S 20.3.

¹⁵⁸ Van Vijfeijken in Kolkman *et al* (2006) 642; Martens and Sonneveldt (2007) 24–25.

¹⁵⁹ S 20.1–20.2. See in general Van Vijfeijken in Kolkman *et al* (2006) 681.

¹⁶⁰ S 20.5 and 20.6. See par 9.9 for a discussion on deferred income tax liabilities. See in general Blokland, Klinkert-Cino and Schutte (1998) Ch 6; Van Vijfeijken in Kolkman *et al* (2006) 682–685 and Martens and Sonneveldt (2007) 22–23.

¹⁶¹ Martens and Sonneveldt (2007) 21.

¹⁶² S 5.2 (as amended by 31 930 A). See in general Van Vijfeijken in Kolkman *et al* (2006) 644–645.

9.5.2 Preferential Valuations

9.5.2.1 Business Property

The first form of business relief under the Act dates back to 1983, with the introduction of a deferred payment system for the inheritance or gift tax liability in respect of business assets.¹⁶³ The motivation behind its implementation was to counter instances where the continuation of businesses was endangered as a result of the tax liabilities.¹⁶⁴ In 1990, a comprehensive relief facility was incorporated into the Collection of Taxes Act.¹⁶⁵ In 2002, following the Moltmaker Report's recommendation,¹⁶⁶ a revised business relief facility (*bedrijfsopvolgingsfaciliteit*) was reintroduced in the Inheritance and Gift Tax Act. The provisions and requirements of the facility were revised with the 2010 tax reform process.

For the purposes of inheritances and gifts, an exemption of 100 percent is (on application of the acquirer) available in respect of the going concern value of "business property"¹⁶⁷ (*ondernemingsvermogen*) where the value of the business does not exceed €1 million.¹⁶⁸

¹⁶³ See Zwemmer (2000) *WPNR* 143 and Zwemmer (2004) *WPNR* 346 for further reading on the first form of business relief.

¹⁶⁴ Zwemmer (2000) *WPNR* 143; Zwemmer (2004) *WPNR* 345; Van Uunen (2000) *WFR* 811; Hoogeveen (2002) *WPNR* 303; Van Vijfeijken and Van Joolingen (2007) *WPNR* 1059.

¹⁶⁵ Martens and Sonneveldt (2007) 211.

¹⁶⁶ Moltmaker Report (2000) 23. However, most of the Moltmaker Report's recommendations in respect of business relief (at 23–36) were never implemented. See Van Rijn *WFR* (2000) 768–776 and Van Uunen (2000) *WFR* 810–820 for discussions on the recommendations.

¹⁶⁷ "Business property" as defined basically includes a business operated through a sole proprietorship or a partnership interest. In addition, it includes a substantial share-interest in a limited liability corporate entity operating a business (s 35c.1(a)–(c)). A substantial interest exists, generally speaking, where a shareholder owns by himself or herself together with his or her partner, directly or indirectly, an interest of at least five percent in the shareholding of the entity (Income Tax Act s 4.6). However, the value of the substantial interest which may qualify for the relief may only include investments the value of which does not exceed five percent of the value of the business (S 35c.1(c).2°). See in general Van Vijfeijken in Kolkman *et al* (2006) 733.

¹⁶⁸ S 35b.1(a).

Where the value of the business property exceeds €1 million, any difference between the liquidation value and the going concern value (where the first value is higher than the second value) as well as the first €1 million of the going concern value will be fully exempt from inheritance or gift tax. In respect of the value exceeding €1 million, an exemption of 83 percent of the going concern value will be available.¹⁶⁹ Prior to 1 January 2010, the relief percentage was set at 75 percent (irrespective of the value of the business property).¹⁷⁰ The exemptions offered are conditional on certain requirements being adhered to in the period following the acquisition of the business property, which will be touched on below. The payment of the tax attributable to the 17 percent of the going concern value may in certain instances be postponed for 10 years, at an interest rate as provided for in the Collection of State Taxes Act 1990.¹⁷¹

To counter the abuse of the facility, it is provided that, in the event of a gift, the donor should have operated the business or held the substantial interest for at least five years prior to the making of the gift.¹⁷² Prior to 1 January 2010 the facility did not contain a similar provision for inheritances. However, the 2010 amendments introduced a

¹⁶⁹ S 35b.1(b).

¹⁷⁰ The percentage was 75% in respect of acquisitions after 1 January 2007. For the period 1 January 2005 – 31 December 2006 the percentage was 60%, and for the period 1 January 2002 – 31 December 2004 the percentage was 30%. Prior to 1 January 2002, when the facility as provided for in the Collection of Taxes Act was applicable, the percentage was set at 25%. At first, the new proposal (31 930 as originally issued) proposed a concession of 90%. For further reading on the initial proposal (for business relief), see Janssen (2009) *WFR* 723 *et seq.*

¹⁷¹ Collection of State Taxes Act 1990 (*Invorderingswet*) s 25.12. See in general Van Vijfeijken in Kolkman *et al* (2006) 736. Prior to 1 January 2002, payment could be made in 10 annual interest-free installments. This provision was replaced with the interest-bearing postponement provision, following a recommendation of the Moltmaker Report (2000) 33. See Sonneveldt in Sonneveldt *ed* (2002) 53–55; Van Rijn *WFR* (2000) 773 (who agrees with the charging of interest) and Bindels (2002) *WFR* 1191.

¹⁷² S 35d. Prior to 1 January 2010, in the event of a gift, the relief would in addition only have been applicable where the donor was at least 55 years of age or was declared disabled for occupational purposes (at least 45 percent). S 35c.4 (as it read before the amendments effected by 31 930 A in 2010). See in general Van Vijfeijken in Kolkman *et al* (2006) 734 and Martens and Sonneveldt (2007) 212.

requirement that the deceased business property owner should have operated the business or held the substantial interest for at least one year prior to his or her death.¹⁷³

The relief offered is also conditional upon the acquirer of the inheritance or gift continuing to receive profits from the business or dividends through the shares for a period of at least five years. In addition, the exemption will be withdrawn where a shareholder disposes of the shares or converts the shares to preference shares within the five-year period.¹⁷⁴

Critics argue that business relief in the form of the remittance of a high percentage of the tax liability creates severe horizontal inequity towards the acquisition of non-business property and is therefore unjustified, especially in view of the fact that the beneficiary of the business property (in most cases) acquires it without any consideration. Various alternative relief measures have been proposed.¹⁷⁵ It has also been suggested that the relief (in its contemporary form) should rather be restricted to cases where the continuation of the business operations are endangered.¹⁷⁶ In response to the extension of the relief with effect from 1 January 2010, critics mention that it is strange that the legislature did not use the window of opportunity to evaluate the foundational justification for the relief.¹⁷⁷

9.5.2.2 *Qualified Country Estates (Landgoederen)*

Property that complies with the definition of “qualified country estates” (*landgoederen*) as provided for in the Estates Act 1928 (*Natuurschoonwet*), which has been declared as

¹⁷³ S 35d.

¹⁷⁴ S 35e.

¹⁷⁵ For further reading, see Van Rijn (2000) *WFR* 768 *et seq*; Zwemmer (2000) *WPNR* 144–145; Hoogeveen (2002) *WPNR* 303; Zwemmer (2004) *WPNR* 345; Zwemmer (2008) *WPNR* 423 and De Wijkerslooth-Lhoëst (2008) *WPNR* 1114 *et seq*.

¹⁷⁶ Van Rijn (2000) *WFR* 768–769; Zwemmer (2000) *WPNR* 144; Bindels (2002) *WFR* 1190; Hoogeveen (2002) *WPNR* 303.

¹⁷⁷ De Wijkerslooth-Lhoëst (2009) *WPNR* 512.

such by the Minister of Agriculture, Nature Management and Fishery and the Minister of Finance on request by the owner of the property, may be valued in accordance to certain preferential rules prescribed in section 7 of that Act.¹⁷⁸

9.5.3 Exemptions

In view of the fact that the value of the exemptions are, where applicable, revised and adapted on an annual basis, the amounts referred to below apply (unless otherwise stated) to inheritances or gifts acquired during the 2010 tax year.

9.5.3.1 Exemptions Applicable to Gift Tax

The following gifts are exempt from gift tax:

- gifts acquired from the Queen or members of the Royal Family;¹⁷⁹
- gifts made by or acquired by the state; as well as gifts made by a province or municipality.¹⁸⁰ Gifts acquired by a province or municipality in the Netherlands are also exempt, but provided that the gifts are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁸¹
- gifts acquired by *algemeen nut beogende instellingen* (commonly referred to as ANBIs).¹⁸² Gifts made by these institutions are also exempt, but provided that they are

¹⁷⁸ Estates Act s 7.

¹⁷⁹ S 33.1.1°. See in general Van Vijfeijken in Kolkman *et al* (2006) 723 and Martens and Sonneveldt (2007) 208.

¹⁸⁰ S 33.1.2°.

¹⁸¹ S 33.1.3°.

¹⁸² S 33.1.4°. An ANBI is an institution, established in any member country of the European Union, the Netherlands Antilles or Aruba or in any other country with which the Netherlands had entered into an information exchange agreement, and which serves a religious, philosophical, ideological, charitable, cultural, scientific or general interest in favour of the society. See Income Tax Act s 6.33.1(b). The general interest of the society should be served, and not the interests of a particular group of persons, such as a local club. See Van Vijfeijken in Kolkman *et al* (2006) 714–715 and Martens and Sonneveldt (2007) 189.

made for the general interest of the society;¹⁸³

- gifts acquired by *sociaal belang behartigende instellingen* (commonly referred to as SBBI),¹⁸⁴ but provided that they are not subject to directions which would alter their cause to something other than social interest;¹⁸⁵
- gift acquired by someone, who is not able to pay his or her debts, provided that the gifts are used to pay such person's creditors;¹⁸⁶
- gifts acquired by an entity, which had been established for the purposes of the promotion of the financial and social interests of the employees or their relatives in the enterprise of the donor;¹⁸⁷
- gifts which are subject to income tax;¹⁸⁸ and
- gifts acquired by virtue of certain natural obligations.¹⁸⁹

An annual exemption (€5 000 for the 2010 tax year) is allowed in respect of gifts by a parent or parents to a child. For a child between 18 and 35 years the Act specifies that the value of the exemption may be increased for one calendar year only (for the purposes of this paragraph referred to as the secondary exemption). For the 2010 tax year the value of the secondary exemption is set at €24 000. The 2010 amendments introduced a provision that the secondary exemption may be increased to €50 000 where the money is to be used

¹⁸³ S 33.1.10°. See in general Van Vijfeijken in Kolkman *et al* (2006) 725 and Martens and Sonneveldt (2007) 208.

¹⁸⁴ An SBBI is an institution established in any member country of the European Union, the Netherlands Antilles or Aruba or in any other country with which the Netherlands had entered into an information exchange agreement and which serves a social interest such as sports clubs and *dorpshuizen*. See s 32.1.8°.

¹⁸⁵ S 33.1.13°.

¹⁸⁶ S 33.1.8°. See in general Van Vijfeijken in Kolkman *et al* (2006) 724–725 and Martens and Sonneveldt (2007) 208.

¹⁸⁷ S 33.1.11°. See in general Van Vijfeijken in Kolkman *et al* (2006) 726 and Martens and Sonneveldt (2007) 209.

¹⁸⁸ S 33.1.9°. See in general Van Vijfeijken in Kolkman *et al* (2006) 725 and Martens and Sonneveldt (2007) 209.

¹⁸⁹ S 33.1.12°. See in general Van Vijfeijken in Kolkman *et al* (2006) 726–727 and Martens and Sonneveldt (2007) 209.

for the acquisition of a primary residence or for the purposes of studies.¹⁹⁰ To provide a concession where a child between the ages of 18 and 35 years had already used the secondary exemption in a previous tax year, it is provided that such a child would for one calendar year (between the age of 18 and 35 years) be entitled to an additional exemption of €26 000 where the money is to be used for the acquisition of a primary residence.¹⁹¹

For all other gifts, a general exemption is available in the amount of €2 000.¹⁹²

9.5.3.2 Exemptions Applicable to Inheritance Tax

The Act provides for the exemption of the following inheritances:¹⁹³

- inheritances acquired by the state;¹⁹⁴
- inheritances acquired by a province or a municipality in the Netherlands, but provided that they are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁹⁵
- inheritances acquired by ANBIs, but provided that they are not subject to directions which would alter their cause to something other than the general interest of the society;¹⁹⁶
- inheritances acquired by SBBIs, but provided that they are not subject to directions which would alter their cause to something other than social interest;¹⁹⁷

¹⁹⁰ S 33.1.5°.

¹⁹¹ S 33.1.6°.

¹⁹² S 33.1.7°.

¹⁹³ For further reading on the historic development of these exemptions, see Hemels (2004) *WPNR* 330–332.

¹⁹⁴ S 32.1.1°.

¹⁹⁵ S 32.1.2°.

¹⁹⁶ S 32.1.3°. See in general Van Vijfeijken in Kolkman *et al* (2006) 714 and Martens and Sonneveldt (2007) 189, 205–206.

¹⁹⁷ S 32. 1.8°.

- the acquisition of pension benefits under a pension plan, in terms of an annuity or by virtue of periodic payments;¹⁹⁸
- an acquisition from an employer or his or her spouse in respect of services supplied in terms of a natural obligation as provided for in civil code 6:3;¹⁹⁹ and
- interest and other income which accrues after the death of the testator (apparently because of the fact that these accruals have been subjected to income tax).²⁰⁰

With effect from 1 January 2010, the Act provides for the following part-exemptions (*voet vrijstellingen*) in respect of inheritances acquired by the following relatives:²⁰¹

Relative	Exempt threshold
Partner	€600 000, reduced by half of the partner's pension entitlements, but provided that the exemption will not be less than €155 000 ²⁰²
Handicapped/sick child	€57 000
Child	€19 000
Grandchild	€19 000
Parent	€45 000

In respect of all other inheritances, an amount of €2 000 is exempt from inheritance tax.²⁰³

¹⁹⁸ S 32.1.5° read with ss 32.3–32.5. See in general Van Vijfeijken in Kolkman *et al* (2006) 718 and Martens and Sonneveldt (2007) 206 (although this was also the position prior to 1 January 2010, the numbering of the section was restructured by 31 930 A).

¹⁹⁹ S 32.1.9°. See in general Van Vijfeijken in Kolkman *et al* (2006) 719 and Martens and Sonneveldt (2007) 206.

²⁰⁰ S 32.1.10°. See in general Van Vijfeijken in Kolkman *et al* (2006) 719–720 and Martens and Sonneveldt (2007) 207.

²⁰¹ S 32.1.4°(a)–(e).

²⁰² S 32.2.

²⁰³ S 32.1.4°(f).

9.6 TREATMENT OF COMMON-LAW TRUSTS

9.6.1 The Trust: An Unknown Phenomenon in the Dutch Law

The common-law trust is in principle an unknown phenomenon in Roman law-based civil law systems. The Dutch law does therefore not recognise a legal institution directly equivalent to such a concept.²⁰⁴ However, the law acknowledges some similar trust-like relationships, such as a *fideicommissum*,²⁰⁵ a nominee account,²⁰⁶ a *bewind*,²⁰⁷ a mandate²⁰⁸ and a foundation,²⁰⁹ where the fiduciary relationship among the persons involved can in various ways be compared with the relationship among the parties to a common-law trust.²¹⁰

²⁰⁴ Hayton, Kortmann and Verhagen (1999) 195–215; Koppenol-Laforce and Sonneveldt (2001) *WPNR* 173 *et seq.* See also Moltmaker Report (2000) 37–39, where the need to provide for a trust-like institution under Dutch law has been acknowledged. However, the proposal for the introduction of a family foundation (*familiestichting*) was not taken any further by the government.

²⁰⁵ See par 9.3.6.

²⁰⁶ A nominee account is a bank account which is maintained by a person (such as an advocate or notary) in his or her capacity as an agent for the benefit of another person (usually a client). See Hayton, Kortmann and Verhagen (1999) 198.

²⁰⁷ In the case of a *bewind*, the beneficiary is the legal owner of assets to be managed by an administrator (*bewindvoerder*). The administrator acts as an agent for the beneficiary. See Hayton, Kortmann and Verhagen (1999) 199–200.

²⁰⁸ In the case of a mandate, a principal may authorise his or her agent to execute acts of management or acts of disposition in respect of assets. For the duration of the mandate, the principal does not have the authority to manage the assets himself or herself. See Hayton, Kortmann and Verhagen (1999) 200–201.

²⁰⁹ A foundation is an entity with legal capacity which is established for an ideal or social purpose and which are managed by administrators. The institution has a function under Dutch law similar to that of the charitable trust in common-law jurisdictions. Under Dutch law, a foundation is created by virtue of a notarial deed (or will). See Hayton, Kortmann and Verhagen (1999) 202. Although the Act contained some specific provisions dealing with foundations (see ss 16 and 17 of the Act as it read prior to the amendments effected by 31 930 A in 2010), these provisions were repealed from the Act by 31 930 A with effect from 1 January 2010, because acquisitions can be taxed in terms of the normal charging provisions.

²¹⁰ See Hayton, Kortmann and Verhagen (1999) 196–203 for a comparative analysis of these and other Dutch trust-like institutions.

As a consequence of the fact that the Netherlands was a signatory to the 1985 Hague Trust Convention (which came into operation in the Netherlands in 1996), a foreign trust must be recognised under Dutch law.²¹¹ It is therefore of paramount importance to understand the applicability of the Inheritance and Gift Tax Act to transfers involving these foreign institutions, for example where a Dutch resident donates property to a foreign trust, or where the object of the transfer to or by the trust involves Dutch *situs* property.

In view of the fact that the Hague Convention does not cover the fiscal position of trusts,²¹² the Minister of Finance announced some policy guidelines in respect of the position of trusts, namely (a) a trust is not a legal entity for the purposes of fiscal legislation; (b) the fiscal consequences of a trust have to be ascertained by applying the analogical legal positions that exist in the Netherlands, and these consequences have to be reconcilable with the Dutch tax legislation; and (c) the trust capital always belongs to either an individual or a legal entity, and can never “float around”.²¹³

Although the common law trust can be classified in various ways, the Dutch literature usually refers to a “fixed trust”, which resembles a trust similar to an interest in possession trust (IIP trust) in the United Kingdom,²¹⁴ and a discretionary trust (where there are no fixed interests in possession). Prior to 1 January 2010, the Act did not contain any specific provisions in respect of trusts. The inheritance tax and gift tax consequences were therefore derived by applying the existing principles. However, a special regime aimed to counter *inter alia* the problematic nature of common-law discretionary trusts and foreign foundations was introduced on 1 January 2010 (the

²¹¹ Hayton, Kortmann and Verhagen (1999) 9; Sonneveldt and De Kroon (2009) *WFR* 734. For further reading on the Hague Convention, see Lupoi (2000) Ch 6.

²¹² Sonneveldt, Bom and Zuiderwijk (1995) 102; Martens and Sonneveldt (2007) 149; Sonneveldt and De Kroon (2009) *WFR* 734.

²¹³ Soares and McCutcheon (1995) 108.

²¹⁴ See Ch 8 par 8.6.1.

afgezonderd particulier vermogen (APV) regime), which will be discussed more fully in paragraph 9.6.3.3 below.

9.6.2 Fixed Trusts

Because the APV regime introduced in 2010 (referred to below) does not apply to fixed trusts, these trusts have remained unaffected by the amendments.

Because the donative intent is directed at the beneficiaries, and not the trustees,²¹⁵ a beneficiary is either liable for inheritance tax or gift tax in respect of the acquisition of a fixed interest through the construction of a benefit on behalf of a third party.²¹⁶ For example, where A (a Dutch resident) donates property to a fixed trust where B holds the life interest and C the remainder interest in the trust absolutely (i.e. a typical life interest trust), both B and C are liable for gift tax in respect of the life interest and remainder interest respectively. The life interest will apparently be valued in accordance with the method provided for the valuation of usufructs.²¹⁷

9.6.3 Discretionary Trusts

9.6.3.1 *The Position Prior to the APV Regime*

A discretionary trust posed some more challenging issues for the application of the Act prior to the introduction of the APV regime in 2010. Where, for example, a (Dutch resident) settlor transferred property into a discretionary trust (where the trustees had the discretion to distribute the income and the capital), a question arose whether a gift

²¹⁵ See Leemreis in Sonneveldt and Van Mens *eds* (1992) 62 and Sonneveldt (2000) *WFR* 776.

²¹⁶ See Leemreis in Sonneveldt and Van Mens *eds* (1992) 62; Sonneveldt Doctoral Thesis (2000) Ch 6; Van Vijfeijken in Kolkman *et al* (2006) 632 and Martens and Sonneveldt (2007) 150.

²¹⁷ Sonneveldt Doctoral Thesis (2000) 76; Martens and Sonneveldt (2007) 150.

occurred for the purposes of the Act. Although the settlor was definitely impoverished, the transfer did not yet result in the complete enrichment of a beneficiary, because of the trustees' intervening discretionary powers. In 1998, the high court had an opportunity to address the tax consequences of such a scenario. It was held that an *inter vivos* transfer of property to a discretionary trust constituted a gift for the purposes of the Act and the trustees were liable for gift tax in accordance with the rates applicable to group 3 (strangers).²¹⁸ Because most trusts are resident outside the Netherlands, the subsequent distribution of assets by the trustees would have fallen outside the scope of the Act (in most instances). As a consequence, it became relatively easy for a person to channel property to a beneficiary in the Netherlands tax-free. Another thorn in the flesh for the tax authorities was that income from trust property escaped income taxation in the absence of specific provisions contained in the income tax legislation.

9.6.3.2 *Proposals for a Solution*

Scholars generally agreed that the position of discretionary trusts was highly unsatisfactory and that some form of legislative intervention was required. Various proposals were put on the table. Sonneveldt suggested two alternative solutions. In terms of his first proposal the chargeable event would be deferred until the eventual distribution of the property to the beneficiary, and this transfer would be assumed to originate from the settlor. However, this approach had a number of disadvantages.²¹⁹ In terms of his second proposal, the disposal to the trust would be treated as a transfer to a separate fund, which is more in line with the approach taken by the judiciary. This proposal called for the implementation of a new fiscal regime applicable to trusts. There would in principle be three charges levied in terms of the proposed regime (at moderate rates), namely (a) an initial charge on the transfer of the property to the trust, (b) a periodic tax levied during

²¹⁸ HR 18 November 1998, *BNB* 1999/35, 36 and 37. See Sonneveldt Doctoral Thesis (2000) 102–114 for a discussion of the case. See also Martens and Sonneveldt (2007) 150–151.

²¹⁹ Sonneveldt Doctoral Thesis (2000) 247–248 (see also summary in English at 279).

the existence of the separate fund and (c) the final (main) charge levied upon the distributions to the beneficiaries.²²⁰

The Moltmaker Report proposed a uniform fiscal regime for trusts and foundations, whereby any disposal to such an entity, except for disposals to a public benefit organisation or a family foundation (as more fully discussed below), would be taxed in terms of the rates applicable to tariff group 3 (the highest).²²¹ Koppenol-Laforce and Sonneveldt criticised this non-transparent approach because it did not differentiate between fixed and discretionary interests.²²² According to Koele this proposal would also have been extremely detrimental to Dutch legal constructions such as certification and the benefit-for-a-third-party arrangements.²²³ The report furthermore proposed the implementation of a new concept, namely the family foundation (*familie-stichting*), an entity (with legal capacity) with characteristics similar to the common-law discretionary trust.²²⁴ This entity would be subject to a special fiscal regime, according to which (a) the initial transfer of property would be taxable at a flat rate of 10 percent, (b) any subsequent distribution to a beneficiary would be treated as a gift, taxable in accordance with the relationship between the settlor and the beneficiary and (c) the foundation would be subject to income tax in respect of any undistributed property.²²⁵

In principle Koele welcomed the planned implementation of a Dutch institution similar to the common-law discretionary trust (although she had some alternative suggestions), but pleaded that the legislature should introduce a uniform regime for all trusts, foundations

²²⁰ Sonneveldt Doctoral Thesis (2000) 248–254 (see also summary in English at 279–280).

²²¹ Moltmaker Report (2000) 37.

²²² Koppenol-Laforce and Sonneveldt (2001) *WPNR* 180.

²²³ Koele (2004) *WPNR* 339–342.

²²⁴ Moltmaker Report (2000) 37–39.

²²⁵ Moltmaker Report (2000) 38. See also Sonneveldt (2000) *WFR* 776, 778–779; Koppenol-Laforce and Sonneveldt (2001) *WPNR* 180–181 and Koele (2004) *WPNR* 336–337 for a summary of the proposal.

and other similar constructions. In respect of transfers to a discretionary trust (or foundation), she suggested that the regime should link up with the idea that the trust is only a conduit-pipe to the eventual beneficiaries. In terms of her proposal (a) the initial transfer of property would be taxable at a flat rate of seven percent, (b) any subsequent distribution to a beneficiary would be taxed as an inheritance or a gift from the settlor (the initial charge of seven percent would, however, be deductible against any inheritance tax or gift tax payable) and (c) any income accrued in the period between the initial transfer and the eventual distribution would be attributed to either the settlor or his heirs (in proportion to their shares under the deceased estate).²²⁶

9.6.3.3 The Introduction of a Regime for Afgezonderd Particulier Vermogen in 2010

On 1 January 2010 the legislature introduced a regime for *afgezonderd particulier vermogen* (APV). The new regime followed neither the proposition of the Moltmaker Report nor those of the other commentators referred to above. Its theoretical underpinning is instead based on the idea of transparency. The APV regime, which involved amendments to the Income Tax Act as well as the Inheritance and Gift Tax Act, basically looks through an APV and attributes the capital, income, debts and expenses to certain persons, as will be described more fully below.

An APV is basically defined as capital which has been secluded by a person for the intended benefit of other persons, other than for the issuing or creation of shares, membership rights, profit shares or any other similar vested rights in respect of the capital.²²⁷ Although this definition is clearly formulated to include (pure) discretionary trusts, Boer and Freudenthal point out that the regime does not apply to mixed trusts, meaning trusts with discretionary interests as well as fixed interests.²²⁸

²²⁶ Koele (2004) *WPNR* 342–344.

²²⁷ The concept is defined in Income Tax Act s 2.14(a).2. For further reading on the meaning and complexities of the definition, see Auerbach (2009) *WPNR* 497–499.

²²⁸ Boer and Freudenthal (2009) *WPNR* 509–510.



The regime operates as follows: where a person (hereafter “settlor”) transfers assets to an APV, the initial transfer will not be taxable under the Inheritance and Gift Tax Act. For income tax purposes, the property and its accompanying liabilities, accruals and losses will be attributed to the settlor (during his or her lifetime), unless a beneficiary acquires a vested life interest (to for example an annuity), in which case the income attributable to such an interest will be attributable to the beneficiary. On the death of the settlor, the trust property, accompanying liabilities, accruals and losses will be attributed to the settlor’s heirs (in proportion to their respective inheritances). Where an heir (or his or her partner or close relative) cannot, directly or indirectly, receive a benefit from such an entity (because he or she is, for example, not included in the list of beneficiaries under the APV), the assets and income will be attributed to the remaining heirs as if the first-mentioned heir was not inheriting from the settlor’s estate. Where the settlor, his or her partner or the heirs could not be ascertained, the assets will be attributed to the beneficiaries of the entity (in proportion to their interests). The income tax consequences as described above will, however, not be applicable in the case where the income is subject to business taxation of at least ten percent.²²⁹

For the purposes of the Inheritance and Gift Tax Act, the attribution of the property to the settlor’s heirs (or the trust beneficiaries) upon his or her death will be deemed to constitute an inheritance from the settlor for the purposes of the Act. An heir (or beneficiary) will therefore become liable for inheritance tax attributable to his or her pro-rata share in the property. Any other distributions from the entity will be deemed to be a gift from the person to whom the property (or a share therein) has been attributed according to the rules described above.²³⁰ For example, where an entity distributes property to a beneficiary during the lifetime of the settlor, the acquisition of the property will be taxed as a gift from the settlor to such beneficiary. Where an entity distributes

²²⁹ Income Tax Act of 2001 s 214a.

²³⁰ Ss 16, 17 and 26a (as amended by 31 930 A).

property to a beneficiary subsequent to the death of the settlor, the acquisition of the property will be taxed as a gift from the heirs (or trust beneficiaries) to such beneficiary.

9.6.3.4 A Storm of Criticism

The APV regime has evoked a storm of criticism. The main objection is directed at the transparency approach chosen by the legislature, instead of treating trusts as individual institutions in accordance with their special characteristics.²³¹ Critics point out that the approach may produce double taxation by taxing the property as an inheritance on the death of the settlor and again as a gift when the property is distributed.²³² They argue that it is simply unfair and unjust to attribute property to heirs of the settlor (on his or her death) irrespective of whether the heirs would indeed benefit from the trust, especially considering that a beneficiary (although provided for as a beneficiary) may not necessarily receive a benefit in future because of the discretion of the trustees.²³³ They also point out that the regime could be avoided by merely appointing institutions as heirs which are normally exempt from inheritance tax (such as ANBIs or even the State of the Netherlands).²³⁴ Another objection is that the Act does not provide principles for the way in which attribution should be accomplished.²³⁵

Over and above these difficulties, the question is posed why the Netherlands has chosen to implement a “transparency” regime which is totally different from the regimes operative in other international jurisdictions.²³⁶ Boer and Freudenthal conclude as follows:

²³¹ Auerbach (2009) *WPNR* 500; Boer and Freudenthal (2009) *WPNR* 511.

²³² Sonneveldt and De Kroon (2009) *WFR* 734–735; Auerbach (2009) *WPNR* 504.

²³³ Sonneveldt and De Kroon (2009) *WFR* 735; Auerbach (2009) *WPNR* 500–502.

²³⁴ Sonneveldt and De Kroon (2009) *WFR* 736; Auerbach (2009) *WPNR* 502.

²³⁵ Auerbach (2009) *WPNR* 502.

²³⁶ Auerbach (2009) *WPNR* 502.

“Waarom denkt de Nederlandse wetgever nu dat het beter is die oorspronkelijke kennis en ervaring weg te gooien, en daarvoor een fictieve transparantie in de plaats te stellen? Natuurlijk moet een heffing op entiteitsniveau worden ingepast in het (inter)nasionale belastingrecht, en natuurlijk is het heffingssysteem op entiteitsniveau niets zonder aanvullende (vestigingsplaats)ficties, maar de oplossing is altijd nog beter dan het thans voorgestelde systeem. Deze staat mijlenver af van de civielrechtelijke belevingswereld, en plaats Nederland op een eiland.”²³⁷

9.7 TREATMENT OF LIMITED INTERESTS AND BARE *DOMINIUM*

The discussion below explains and illustrates the treatment of limited interests and bare *dominium* under the current regime.

9.7.1 The Position of Bare *Dominium*

The transfer of bare *dominium* (whether *inter vivos* or on death) is immediately chargeable and not deferred until it materialises into full ownership. This position may sometimes conceal a passive transfer of wealth through passage of time, as will appear more fully from the example below:

Example 1

A bequeaths a lifelong usufruct in favour of his wife B over property worth €1 million and donates the bare *dominium* in the property to his son C. The value of the bare *dominium* in C's hands will be valued as the difference between the market value of the property and the value of the usufruct calculated with reference to B's life expectancy at that point in time (say, a value of €800 000). Assuming that the 2010 exemptions apply and that B is entitled to an exemption of €600 000, then B will be liable for gift tax on €200 000. C will only be liable for gift tax on €181 000 (€200 000 - €19 000). If B dies 10 years later at a time when the market value of the property is €1.5 million, then the accrual of the enjoyment of the property to C will not attract any inheritance tax.

²³⁷ Boer and Freudenthal (2009) *WPNR* 511.

From a theoretical point of view, the above position is justifiable, because the bare *dominium* owner paid either gift tax or consideration for the acquisition of the bare *dominium*. Such a person was deprived of the use and enjoyment of the property for the duration of the usufruct. However, it should be obvious that an owner may transfer property to another using the passage of time and exemption thresholds to complete the transfer at a minimal tax cost.

9.7.2 The Creation of Limited Interests

The transfer of a limited interest to another person constitutes a taxable transfer in the hands of such person, calculated over his or her the life expectancy (in the case of a lifelong interest) or a fixed period of time (where the interest is granted for a certain period only).²³⁸ What is significant to observe is that the tax consequences for the interest holder is exactly the same whether the interest is granted to him or her during the life of the owner of the property, or upon such person's death, as will more fully appear from the example below:

Example 2

- 2.1 A (male, age 74) bequeaths property worth €1 million to his grandson C subject to a lifelong usufruct in favour of his son B (male, age 45). Ignoring any exemptions and rebates, B will be liable for inheritance tax on the usufruct valued at €780 000 and C will be liable for inheritance tax on the value of the bare *dominium* (€220 000).
- 2.2 A (male, age 74) donates property worth €1 million to his grandson C subject to a lifelong usufruct in favour of his son B (male, age 45). Ignoring any exemptions and rebates, B will be liable for inheritance tax on the usufruct valued at €780 000 and C will be liable for inheritance tax on the value of the bare *dominium* (€220 000).

It is evident from examples 2.1 and 2.2 above that the “aged-donor” phenomenon (pointed out under the South African law)²³⁹ is not mirrored in the Dutch system, because

²³⁸ See pars 9.3.3 and 9.3.4.

²³⁹ See Ch 7 par 7.4.4.3.

the circumstances of the beneficiary determine the value of the usufruct as well as the value of the bare *dominium* (whether the transfer occurs *inter vivos* or on death).

Limited interests may also be granted successively. The example below illustrates the tax consequences:

Example 3:

A bequeaths property valued at €200 000 to his grandson D, subject to A's son B (age 53) having a lifelong usufruct over the property and A's daughter C (age 40), on B's death, being entitled to a successive usufruct on the property for the duration of her life. D will only become the full owner of the property on C's death (provided that C survives B). D will only once be liable for inheritance tax on the value of the bare *dominium* on A's death, which will be calculated in accordance with the appropriate factor established with reference to a person aged 35. The (joint life) usufruct will be valued at €168 000. D will therefore be liable for inheritance tax on €32 000 (less any exemptions). B will, however, only be liable for inheritance tax on the value of his usufruct calculated with reference to his own age, namely €144 000 (less any exemptions). When C becomes entitled to the enjoyment of the property on B's death, C will be liable for inheritance tax in respect of that (successive) usufruct calculated on the market value at that point in time with reference to her age at that date (less any exemptions).²⁴⁰

9.7.3 The Termination of Limited Interests

The lapse of a limited interest through expiration of time does not constitute a taxable event.

Where an interest holder renounces (even unilaterally) an interest, any gain “transferred” to the successor to the enjoyment of the property is specifically captured in the tax base. Where the enjoyment/fruits of the property accrues to the bare *dominium* owner, then he or she is liable for gift tax on the value of his or her “gain”, calculated with reference to the “unexpired” period of the interest, namely with reference to the life expectancy of the interest holder (at the moment of renunciation) or the unexpired period of time (in the case of a fixed period interest).

²⁴⁰ See Martens and Sonneveldt (2007) 166–167.

On the other hand, an interest that ceases as a result of death is not captured under the tax base, except in cases where the section 10 fiction applies, the operation of which is illustrated in example 5 below. The absence of tax consequences on death is theoretically acceptable if one considers that death, like termination through passage of time, is a natural cause of cessation of interests (unlike renunciation, which requires at least wilful conduct by the interest holder). However, any “benefit” acquired by the bare *dominium* owner on the unexpected death of the usufructuary falls outside the scope of the Act. Consider the following example:

Example 4

A bequeaths property worth €1 million to his grandson D subject to a lifelong usufruct in favour of A’s son B. B will be liable for inheritance tax on the value of the usufruct (calculated with reference to his or her life expectancy at that point in time), say €800 000 (less any exemptions). D will be liable for inheritance tax on the bare *dominium* of €200 000 (less any exemptions).

- 4.1 Where B renounces the usufruct after one year, D will be liable for gift tax on the value of the “unexpired period” of the interest, calculated over the life expectancy of B (on the moment of renunciation), say €750 000 (less any exemptions).
- 4.2 However, in the event where B dies after one year, D will not be responsible for any tax on the accrual of the right of enjoyment.

Example 4 illustrates that there is no neutrality between the case where D receives earlier possession under a renunciation and the case where D receives earlier possession because of death. This happens because it is virtually impossible to value a usufruct accurately upon the acquisition thereof because of the uncertainty of its natural period (even in the case of a fixed period usufruct which can also be terminated by an earlier death). In the absence of any specific provisions (other than the section 10 fiction explained below), a bare *dominium* owner may therefore passively “acquire” a benefit as a result of the death of the usufructuary, a benefit that will be greater the sooner the usufructuary dies.

9.7.4 The Section 10 Fiction – Usufruct & Bare *Dominium*

The example below illustrates a classic scenario for which the section 10 fiction was designed:

**Example 5**

A is the owner of land valued at €1 million. During his life, A transfers the bare *dominium* in the property to his son B for €50 000, retaining a lifelong usufruct in favour of himself. A dies two years later (when the property is valued at €1.2 million). In the absence of any special provisions, B will not be liable for any inheritance tax on the accrual to him of the right to enjoyment of the property on A's death.

The section 10 fiction deems the accrual of the right of enjoyment to B (in the example above) to be an inheritance by B from A of the *full* value of the property on A's death. A concession is granted by the provision that the value of the deemed inheritance may be reduced by any consideration paid by B for the initial acquisition of the bare *dominium* (plus interest at six percent).²⁴¹ Applied to the facts in example 5 above, the operation of section 10 will cause B to take an inheritance from A on A's death of €1 144 000 (€1.2 million - €50 000 - €6 000 (two years' interest at six percent)), less any exemptions.

Although section 10 is clearly designed to counter the exploitation of the legal position between related parties (note that the fiction is only applicable where the bare *dominium* owner is a partner or close relative of the deceased), its foundational justification seems questionable. Van Vijfeijken argues that the fiction is strictly speaking not in harmony with the underlying approach of a recipient-based tax, because the bare *dominium* owner either paid for the bare ownership or was liable for gift tax in respect of the acquisition thereof.²⁴² However, it was suggested in paragraph 9.7.1 above that, although this viewpoint is commendable from a theoretical point of view, it seems as if a transferor may, in the absence of some countering provisions such as provided for in section 10, be tempted to "transfer" property through passage of time, especially because the taxation of the bare *dominium* is not deferred until it materialises into full ownership and because the death of an interest holder is not otherwise accommodated under the ordinary rules.

²⁴¹ See par 9.2.3 par (e).

²⁴² Van Vijfeijken (2002) *WPNR* 179–180 and 185; Van Vijfeijken (2009) *WFR* 716–717.

Nevertheless, the question is whether the section 10 fiction (whether justifiable in theory or not) represents an appropriate and fair way to deal with the passive “transfer” of benefits to the bare *dominium* owner. It is herewith suggested that the fiction contains a number of inequities, a few of which are pointed out below:

- The fiction relates only to the partner or close relative of the deceased. This disturbs the horizontal equity between a case involving these relatives and all other cases, especially where a relative paid an arm’s length consideration for the bare *dominium*;
- The fiction is applicable only where the deceased retains for himself a *lifelong* limited interest. Where, for example, A retains for himself a (say) 40-year usufruct and donates the bare *dominium* to his son, and A survives the 40-year period, the lapse of the usufruct will not constitute a taxable event and section 10 will not be applicable on A’s death. Although one can in principle understand that, theoretically, the son paid adequate consideration for the bare *dominium*, the point is this: why should a lifelong interest be disadvantaged if compared to a fixed period interest (where it is possible to escape the claws of section 10)?
- The fiction is only applicable where the deceased retains for himself an interest during his lifetime, and not where the deceased “splits” the interests by granting an interest to another person (during his lifetime) and by transferring the bare *dominium* to his partner or close relative. The facts set out in example 1 will therefore not fall within the scope of section 10.

9.8 GENERAL ANTI-AVOIDANCE RULE

Apart from some specific anti-avoidance provisions, the Act does not provide for a general anti-avoidance measure.



9.9 INCOME TAX (CAPITAL GAINS TAX)

9.9.1 Income Tax (Capital Gains Tax) Consequences

Although the Dutch tax system does not provide for the levying of a capital gains tax as such, the Dutch Income Tax Act of 2001 provides for the levying of charges on three different categories of income (referred to as “boxes”), each with their own tariff. Box 1 is a progressive tax on wages, profits, social security benefits, owner occupied dwellings and pension benefits; Box 2 is a flat tax of 25 percent on income from a substantial business interest (in general a shareholding of at least five percent in a private company or partnership), such as dividends and (capital) gains realised on the realisation of such interest, and Box 3 is a flat tax of 30 percent on a fixed assumed yield of four percent on the total value of the taxpayer’s savings and investments (effectively taxed at 1.2 percent per year).

For income tax purposes an interest in a personal enterprise (a sole proprietorship or a partnership) is deemed to be transferred upon the death of the owner at its fair market value to the person who acquires such enterprise.²⁴³ The tax liability in respect of any taxable reserves will constitute a liability in the hands of the deceased taxpayer, which will form part of his or her deceased estate. In view of the fact that the heir of the business interest will in fact be burdened with the payment of the (Box 1) tax, the Income Tax Act provides that such person may take over the book value of the taxable reserves and thereby account for tax in respect thereof in the future.²⁴⁴

The transfer of a substantial business interest by virtue of an inheritance is also deemed to be a realisation event in the hands of the deceased for the purposes of (Box 2) income

²⁴³ Income Tax Act s 3.58; Martens and Sonneveldt (2007) 171.

²⁴⁴ Income Tax Act s 3.62; Martens and Sonneveldt (2007) 171.

tax.²⁴⁵ However, where the heir of the business interest is an individual resident of the Netherlands, the acquisition of the interest (if it occurred in a period of two years from the death of the transferor) will not be deemed to be a realisation event where the business constitutes an active enterprise.²⁴⁶ In that case the cost base of the deceased will be carried over to the heir.²⁴⁷

9.9.2 Interaction with Inheritance Tax

Although the liabilities for the (Boxes 1 and 2) income tax on death may be deferred (as explained above), the Inheritance and Gift Tax Act accounts for these future liabilities.²⁴⁸

In the case of a Box 1 deferred income tax liability, the Inheritance and Gift Tax Act (for the purposes of inheritance tax) allows the acquirer a deduction of 20 percent of the taxable reserves (30 percent of any pension reserves) and 20 percent of the goodwill against the value of the business interest comprised in the inheritance.²⁴⁹

In the case of a Box 2 deferred income tax liability (where the base cost is actually carried over to the heir) the Inheritance and Gift Tax Act (for the purposes of inheritance tax) allows the heir a deduction of 6,25 percent of the (capital) gain against the substantial business interest comprised in the inheritance.²⁵⁰

²⁴⁵ Income Tax Act s 4.16 (e). See in general Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁶ Income Tax Act s 4.17. See in general Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁷ Sonneveldt in Sonneveldt *ed* (2002) 43.

²⁴⁸ See Dijkstra (2008) *WPNR* 447–449 for a comprehensive summary.

²⁴⁹ S 20.5 and 20.6; Martens and Sonneveldt (2007) 171.

²⁵⁰ S 20.5 and 20.6. See in general Sonneveldt in Sonneveldt *ed* (2002) 43.



9.10 CONCLUSIONS

- (a) In the Netherlands the taxation of wealth transfers is currently accommodated in a single statute under the Inheritance and Gift Tax Act.²⁵¹
- (b) The Act nonetheless levies separate taxes on “gifts” and “inheritances” (respectively referred to as “gift tax” and “inheritance tax”) in terms of separate charging provisions,²⁵² because the Act is based on nineteenth-century legislation where these taxes developed as two separate taxes at different points in time.²⁵³ To broaden the tax base for the purposes of both taxes, the Act contains a number of fictitious acquisitions.²⁵⁴
- (c) Despite the separate charging provisions, the rules pertaining to the jurisdictional basis, rate structures and the ordinary valuation rules (as discussed in paragraph 9.3) apply equally to *inter vivos* transfers and transfers on death.²⁵⁵ What seems to disturb horizontal equity, however, is that a number of double taxation agreements cover transfers on death only. This position appears to be unwarranted if one considers that the unilateral relief provisions (which are applicable only in the absence of a double taxation agreement with a particular country) apply to both *inter vivos* transfers and transfers on death.²⁵⁶

²⁵¹ See par 9.1.1 n 10 and accompanying text.

²⁵² See pars 9.2.1 and 9.2.2.

²⁵³ See par 9.1.1.

²⁵⁴ See par 9.2.3.

²⁵⁵ See pars 9.2.4, 9.1.2 and 9.3.

²⁵⁶ See par 9.2.5.

- (d) The preferential valuation regimes for qualified country estates and business property apply to both gifts and inheritances, except that the minimum-ownership requirement for the purposes of the business relief differs depending on whether the business is transferred by way of a gift (in which case a period of five years is required) or by way of an inheritance (in which case a period of only one year is required), arguably because death is usually an unplanned event, whereas a gift requires an intentional act.²⁵⁷
- (e) In the area of exemptions, the legislature distinguishes between exemptions applicable to gifts (in section 32) and exemptions applicable to inheritances (in section 33). In some cases, an exemption offered for a gift is also correspondingly offered for an inheritance. For example, an exemption is offered for a gift or inheritance acquired (or, in the event of a gift, sometimes made by) the state, a province, a municipality, an ANBI and an SBBI. In other cases, the exemptions differ. Although the differences are usually justifiable or at least explainable because of the difference in circumstances between a transfer that occurs during life and a transfer that occurs on death, there seem to be a few minor instances where the differentiation seems incomprehensible. For example, a gift acquired from the Queen or members of the Royal Family is exempt from gift tax, but an inheritance acquired from one of these persons is not correspondingly exempt from inheritance tax.²⁵⁸
- (f) Although the Act stems from early nineteenth-century transferor-based legislation,²⁵⁹ it resembles a typical example of a classical recipient-based

²⁵⁷ See par 9.5.2.

²⁵⁸ See par 9.5.3.

²⁵⁹ See par 9.1.1.

tax, where the relationship between the transferor and the recipient is significant in the calculation of the tax and where acquisitions are generally taxed on an individual basis as and when they accrue. However, the system contains some transferor-based elements, such as the section 10 fiction²⁶⁰ and the connection with the transferor in establishing the jurisdictional basis of the tax.²⁶¹ The paragraphs below will highlight some characteristics and problem areas (similar to the areas identified under the South African wealth transfer tax system in Chapter 7).²⁶²

- (g) It is evident that the Dutch system experiences difficulties in demarcating the jurisdictional basis. As a consequence of the repeal of transfer tax (which embodied *situs*-based taxation in respect of non-residents), the Dutch wealth transfer tax base is now restricted to a worldwide basis for residents only.²⁶³ It remains to be seen whether Dutch property owned by non-residents is going to escape Dutch wealth transfer taxation indefinitely, especially if one considers that *situs*-based taxation for non-residents is commonly followed in international wealth transfer tax systems and that double taxation agreements often allocate the primary taxing rights to the contracting state in which the taxable property is located.
- (h) Scholars have pointed out that, from a theoretical perspective, the jurisdictional basis should actually be established with reference to the status of the beneficiary, being the taxpayer. It was, however, explained that most jurisdictions (globally speaking) levy wealth transfer taxation

²⁶⁰ See par 9.2.3(e).

²⁶¹ See par 9.2.4.1.

²⁶² See Ch 7 par 7.4.

²⁶³ See pars 9.1.1 and 9.2.4.

with reference to the status of the transferor. In addition, the 1982 OECD model convention allocates higher preference to a contracting state levying taxation linked to the status of the transferor (than a state levying taxation with reference to the status of the beneficiary).²⁶⁴

- (i) The Dutch system provides an example of a system where the characteristics required for a taxable gift include (a) an intention of generosity on the part of the donor (*oogmerk van liberaliteit*), (b) the impoverishment of the donor and (c) the enrichment of the donee. This approach ensures that ordinary expenditures and *bona fide* business transactions fall outside the scope of the Act, although it would appear that the requirement of intention (which is sometimes difficult to establish) may create difficulties for the taxing authorities.²⁶⁵

- (j) Because life insurance benefits payable to third parties do not pass through the deceased estate of the insured, the Act includes the acquisition of life insurance benefits by a third party in the tax base through a fictitious acquisition. Prior to 1 January 2010, the benefits were taxed in full where the deceased contributed “something” to the policy. A deduction was, however, offered for all the premiums paid by the beneficiary. Since 1 January 2010, benefits are only taxable “to the extent” that the deceased contributed to the policy, which means that policy benefits are only taxable to the extent that they were funded by the deceased. This approach ensures that key-man policies, policies affected in terms of buy and sell arrangements and the half-share of a person who was married with the deceased are sheltered from the tax base.²⁶⁶

²⁶⁴ See par 9.2.4.1.

²⁶⁵ See par 9.2.1.

²⁶⁶ See par 9.2.3(i)(a).



- (k) Taxable acquisitions are not restricted to benefits which can be immediately enjoyed. The transfer of bare *dominium* property is therefore not deferred until it materialises into full ownership.²⁶⁷
- (l) It was shown that this position may be exploited to conceal a passive transfer through passage of time, especially because the system does not include (except for the section 10 fiction) a passive “transfer” of benefits on the death of an interest holder.²⁶⁸
- (m) Because the Act operates on a recipient basis, the “aged donor” phenomenon, illustrated under the South African system, does not pose a tax avoidance opportunity under the Dutch regime.²⁶⁹
- (n) The termination of a limited interest on the death of an interest holder resembles a problem area under the Act. An indirect “transfer” of wealth on the death of an interest holder is not captured in the tax base. As a result, there is no neutrality between a “transfer” of the unexpired period of enjoyment on a renunciation (which is included in the tax base) and a “transfer” of the unexpired period of enjoyment on the death of the interest holder (which is not included in the tax base).²⁷⁰ Although the inclusion of a “transfer” on the death of an interest holder is debatable, the nub of the problem is that it is virtually impossible to accurately value a limited interest upon acquisition because its period of enjoyment is uncertain. Even a fixed period interest may be terminated before natural expiration as a consequence of renunciation or death. Nevertheless, and leaving aside

²⁶⁷ See par 9.7.1.

²⁶⁸ See par 9.7.1.

²⁶⁹ See par 9.7.2.

²⁷⁰ See par 9.7.3.

the issue of whether a passive “transfer” occurs on death, it was shown that the absence of tax consequences on death creates some opportunities for tax avoidance through the use of artificial actuarial values, in the absence of any special provisions. The inclusion of the section 10 fiction was an attempt by the legislature to counter the most obvious avoidance scheme where the owner of property would be tempted to transfer the bare *dominium* in the property to a future heir during the owner’s life, retaining a usufruct in favour of him- or herself. In the absence of any special provisions, the death of the owner would carry no inheritance tax consequences. For years this fiction was relatively easy to circumvent. Although some of these avoidance schemes were closed down with the amendments effected in 2010, it seems as though the scope of the fiction (as amended) may still be by-passed. In addition, it is arguable that the limited scope of the fiction raises equity concerns. The fiction could therefore, in theory, operate quite unfairly.²⁷¹ It seems as if the Dutch system is struggling to find a balance between, on the one hand, acknowledging that death (being a natural cause for the cessation of a limited interest) does not truly reflect an event where benefits are transferred to another, and on the other hand, recognising the possibility of exploitation.

- (o) The use of an interest-free demand loan has also created a tax avoidance loophole in the Dutch system. It is submitted that the provision introduced in the Act with effect from 1 January 2010 by deeming the absence of market-related interest to be a gift to the debtor by the creditor of a usufruct over the money on a daily basis, seems to present a relatively easy and simple method to counter this estate-freezing technique.²⁷²

²⁷¹ See par 9.7.4.

²⁷² See par 9.2.3(1).



- (p) The treatment of transfers to and from a common-law trust has posed some of the most challenging issues for the Dutch system, especially in the realm of discretionary trusts. Moreover, the income derived from trust property escaped the Dutch income tax net (prior to the amendments introduced on 1 January 2010). As a consequence, a number of scholars and the Moltmaker Commission called for legislative intervention and a few proposals were put on the table. The central idea was that a trust should be personified for the purposes of inheritance/gift tax and income tax. However, the legislature introduced a regime for *afgezonderd particulier vermogen* (APV) on 1 January 2010, which was a far cry from the proposals put forward. The basic theoretical underpinning of the regime is that the existence of a discretionary trust is totally disregarded (for the purposes of inheritance and gift tax as well as income tax). The trust property, income, accruals and expenses of the trust are in general attributed to either the settlor (during his or her life) or the settlor's heirs (after his or her death). Any distribution from the trust is treated as a transfer from the settlor (or his or her heirs) to the beneficiary. It was pointed out that the APV regime has elicited a storm of criticism among Dutch scholars, the main point of criticism being that the regime is foreign to the international trend of personifying trusts for the purposes of taxation.²⁷³
- (q) The Act provides relief for business property (the definition of which may include agricultural property) in the form of a substantial remittance of the tax liability. Some commentators have expressed their concern that the relief increases horizontal inequity towards non-business assets and should

²⁷³ See par 9.6.



rather be limited to businesses where the tax liability endangers the continuation of the operations.²⁷⁴

- (r) Although the main apparent disadvantage of a recipient-based tax is administrative difficulties (because of the larger number of taxpayers), it would seem that the Dutch system does not experience any particular problems in this area, arguably because taxpayers are themselves obliged to disclose the acquisition of all inheritances and gifts to the taxing authorities. Also, heirs (or the executor on behalf of the heirs) may submit a joint tax return, which simplifies the system to a certain extent.²⁷⁵

The next chapter will review wealth transfer taxation in Ireland.

²⁷⁴ See par 9.5.2.1.

²⁷⁵ See par 9.4.