Dear Colleagues:

As you are no doubt aware, the IATJ will be holding its 3rd Assembly in Munich, Germany on October 18 and 19, 2012. The agenda and substantive program have now been finalized and I have attached same for your information. Please note the educational aspect of the program, which I believe you will find very substantive and of interest to all.

I solicit you and your colleagues to take this opportunity to attend the 3rd Assembly. The substantive program deals with some very significant topics which we frequently have to deal with in all of our respective jurisdictions. Also, there are many opportunities for you to meet fellow colleagues from around the world and discuss issues of mutual concern.

Also, I attach hereto an article by Past President Vimal Gandhi of India entitled "Trust Laws and their Fair Application". I am sure you will find this article of interest and helpful in carrying out your judicial duties.

Again I thank you for your continued participation and support of the IATJ.

Kindest personal regards,
E.P. Rossiter, President

The 2011-2012 executive for the IATJ is:

Associate Chief Justice Eugene Rossiter (Canada), President
Judge Philippe Martin (France), 1st Vice-President;
Judge Bernard Peeters (Belgium), 2nd Vice-President;
Judge Friederike Grube (Germany), Secretary-General
Judge Willem Wijnen (Netherlands), Treasurer

executive members at large include: Judge Virgilijus Valancius (Lithuania), Judge Peter Panuthos (U.S.A.), Counsellor João Francisco Bianco (Brazil), Judge Dagmara Dominik-Ogińska (Poland), Justice Richard Edmonds (Australia), Justice Clement Endresen (Norway), Pramod Kumar (India), Judge Manuel Garzón (Spain), President Brahim Zaim, (Morocco), Dr. Manuel Luciano Hallivis Pelayo (Mexico)

IATJ 3rd Assembly
October 18 and 19, 2012

Gasteig München GmbH
Rosenheimer Strasse 5,
Munich, Germany

AGENDA

Wednesday, October 17, 2012

5:30 p.m. Meeting of the Executive and Board of Directors

Thursday, October 18, 2012

8:00 a.m. to 9:00 a.m.	Registration
9:00 a.m. to 10:00 a.m.	IATJ Business Meeting
10:00 a.m. to 10:15 a.m.	Health Break
10:15 a.m. to 12:30 p.m.	Substantive Session **Interpretation of Tax Treaties (2.25 Hours)**
12:30 p.m. to 2:00 p.m.	Lunch
2:00 p.m. to 3:30 p.m.	Substantive Session **GAAR & Judicial Anti-Abuse Doctrines**
3:30 p.m. to 3:45 p.m.	Health Break
3:45 p.m. to 5:15 p.m.	Substantive Session **GAAR & Judicial Anti-Avoidance Continued (3 Hours)**
7:30 p.m.	Cocktail Reception – Bundesfinanzhof

Friday, October 19, 2012

9:00 a.m. to 10:30 a.m.	Substantive Session **Judicial Independence**
10:30 a.m. to 10:45 a.m.	Health Break
10:45 a.m. to 11:30 a.m.	Substantive Session

	Judicial Independence continued (2.25 hours)
11:30 p.m. to 12:30 p.m.	Substantive Session **Agency permanent establishment – the commissionaire question**
12:30 p.m. to 2:00 p.m.	Lunch
2:00 p.m. to 3:30 p.m.	Substantive Session **Agency permanent establishment – the commissionaire question** **(2.50 hours)**
3:30 p.m. to 3:45 p.m.	Health Break
3:45 p.m. to 5:15 p.m.	Substantive Session **VAT (1.25 hours)**
5:00 p.m. to 5:15 p.m.	Substantive Session **Excise Duties in the European Union** **(15 minutes)**
5:30 p.m.	Cocktail Reception
7:30 p.m.	Closing Dinner Guest Speaker: Prof. Dr Heinz-Jürgen Pezzer

Saturday, October 20, 2012

5:00 p.m.	Meeting of the Executive and Board upon Return from the "Wendelstein" excursion.

Programme Co-Chairs:

Patrick Boyle, Tax Court of Canada
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IATJ 3rd Assembly Munich 2012 – Substantive Program

Thursday, October 18, 2012

Topic	Schedule	Chairman	Panellists
Tax Treaty Interpretation	10:15-12:30	Wim Wijnen Manuel Hallivis-Pelayo	1. Introduction: Wim Wijnen (The Netherlands) 2. The use of the Vienna Convention: Christian Levedag (Germany) 3. Legal bindingness of the OECD MC Commentaries: Hans Pijl (The Netherlands) 4. Article 3(2) of the OECD Model: Manuel Hallivis-Pelayo (Mexico) 5. Conflicts of qualification: problems with the translation of the word "enterprise" (Art. 7 OECD MC) to other languages and recent case law in Brazil concerning its application: João Francisco Bianco (Brazil)) 6. Static vs. dynamic approach: Peter Wattel (The Netherlands) 7. Methodology, summary and discussion: Manuel Hallivis-Pelayo (Mexico)
Anti-Avoidance Rules	14:00-15.30 15:45-17:15	Gerald J. Rip	1. Patrick Boyle, (Canada) 2. ECJ: N.N. (France) 3. Bernard Peeters (Belgium) 4. Anette Kugelmüller-Pugh (Germany) 5. Anthony D. Gafoor (Trinidad & Tobago)

Friday, October 19, 2012

Topic	Schedule	Chairman	Panellists
Judicial Independence	9:00-10:30 10:45-11:30	Jan Robert Koopman	Peter Panuthos (U.S.A.) Pramod Kumar (India) Emmanuelle Cortot-Boucher (France) Brahim Zaim (Morocco)
Agency permanent establishment – the commissionaire question	11:30-12:30 14:00-15:30	Hans Pijl	Introduction and case studies: Hans Pijl (The Netherlands) Norwegian jurisdiction: Clement Endresen French jurisdiction: Philippe Martin Spanish jurisdiction: Manual Garzon
VAT	15:45-17:00	Friederike Grube	Interpretation of Art. 90 of the Directive 2006/112/EC(ECJ C-588/10) Dagmara Dominik-Oginska (Poland) Friederike Grube (Germany)
Excise Duties in the European Union	17:00-17:15	Harald Jatske	Harald Jatske (Germany)

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Trust Laws and their Fair Application

Vimal Gandhi

Trust is not a legal entity at common law, yet it is widely accepted as the most innovative contribution of the English legal system. Created and shaped in 12th & 13th centuries by Lord Chancellors while enforcing equitable obligations when common law was of no avail, trusts today manage charities, pensions, mutual funds, sports, publications, education etc pervading all walks of life. Significant role of trusts in most common law systems and it's success has led some civil law jurisdictions, most notably France, to incorporate concept of trusts in their civil codes. While in most cases, trusts have laudable purposes, at times they are created as a vehicle for tax avoidance. In India, hundreds of trusts were created to benefit one or few individuals as trustees in such cases were, liable to no tax or tax at a lower rate. Cases of off shore trusts with paper trustees, only to avail benefit of exemptions under Double taxation Avoidance Agreements (DTTA), have also come before courts in the West. Very recently on April 12, 2012, the Honorable Supreme Court of Canada in the case of St Michael Trust Corporation v. Her Majesty, The Queen 2012 SCC 14 upheld for the first time the application of the test of "central management and control" to determine the residence of trusts departing from the precedent that a trust is deemed to be resident where the trustees reside.

Brief facts of the case

Brief facts of the case are that Fundy settlement (Mr. Ganon, his wife & descendant as beneficiaries) and Summersby settlement (Mr. Dunin, his wife & descendants as beneficiaries) were settled by a person resident of St Vincent in Caribbean island. St. Michael Trust Corporation resident of Barbados is the trustee of both the Trusts. A transaction carried by trusts in the year 2000 gave rise to Capital Gains on which tax of over 152 million dollars was deducted and deposited with the Canadian Government as withholding tax. These trusts sought refund of withholding tax as under *Canadian-Barbados Avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income and on Capital (the treaty),* the tax on Capital gains is payable in the contracting state of which the seller is resident. The Trusts on account of residence of the trustee claimed to be resident of Barbados and not of Canada and therefore, not liable to capital gain tax under the treaty. St. Michaell Trust sought the refund of the withholding tax. This claim was refused, as according to the Minister of National Revenue, both the Trusts were resident of Canada and liable to capital gains tax. The Minister also raised other grounds to support the levy, but those grounds were not considered by the Hon'ble Supreme Court and therefore are not being referred to here.

Some important circumstances relating to management of trust, found by Woods J. of the Tax Court and accepted by the Hon'ble Supreme Court are as under:-

> *(a) The terms of each trust provided for a protector who had the power to remove and replace the trustee of the trust. Mr Dunin, and his wife in turn, had power to remove the protector of Summers by trust, while Mr Garron and his wife had the power to remove protector of the Fundy trust. Indirectly each family had the ability to remove the trustee of it's trust.*
>
> *(b) The trustee's internal memorandum indicated that the trustee was expected to play a limited role in the trust transaction.*
>
> *(c) The trustee appear to have limited role in investment making decisions and used Mr Dunin's and Mr Ganon's advisors. Investment advisors were taking directions from Mr Dunin and Mr Garron.*
>
> *(d) There was little documentation indicating that the trustee played a larger role in managing the trust.*

The tax court accordingly held that both the trusts were resident in Canada as their central management and control was carried out in Canada by the main beneficiaries of the trusts residing in Canada. The Supreme Court agreed with the Minister that the trusts had a liability in Canada and withheld tax was properly payable. The decisions of Tax Court of Canada and of the Federal Court of appeal were upheld.

The Hon'ble Supreme Court rejected the arguments of the tax payer based on two fundamental propositions (a) the trust is not a "**person**" like a corporation, so the Central Management and Control test is inapplicable to a trust. The Court held that under Section 104(2), the trust is deemed to be an individual and therefore the fact that at common law, a trust does not have an independent legal existence, was irrelevant. (b) The Honorable Court also rejected the contention of the tax payer that under Section 104(1), a trust is linked to the trustees and therefore the residence of the trust must be the residence of the trustee. It was pointed out that the Federal Court of Appeal had held that above provision existed for the purpose of solving ***"the practical problems of tax administration that would necessarily arise when it was determined that trusts were to be taxed despite the absence of legal personality".*** The Supreme Court agreed and has further added that , what has been asserted (the link), is not a principle of general application that would suggest that residence of trustee must be the residence of a trust. The tax payer could not point out to any provision that would support his argument.

The Honorable court relied upon the basic charging section 2(1) and it's reference to ***"person"*** which according to the court, must be read as a reference

to the tax payer, which in the case was the trust and not the trustee. Section 104(2), also separates the trust from the trustee in respect of trust property. The Honorable court found similarities between a trust and a corporation and noted some of them in para 14 of the judgment and specifically quoted with approval the observations of Woods J. ***"the function of each is, at a basic level, the management of property".*** As with corporations, residence of a trust should be determined by the principle that a trust resides for the purposes of the Act where ***"it's real business is carried on"*** The Honorable court saw no good reason why rule of "Central management and control" should not be applied to determine the residence of the trust as courts in Canada and England [De Beers Consolidated Mines Limited vs. Howe, [1906] A.C. 455 (H.L)] have applied the test to determine the residence of corporations. The Hon'ble Court made a specific reference to Woods J.'s observations that adopting a similar test for trusts and corporations promotes, "**the important principle of consistency, predictability and fairness in the application of tax laws.**" The Honorable court, however, clarified, "this is not to say that the residence of a trust can never be the residence of the trustee. The residence of a trustee will also be residence of the trust where the trustee carries out the central management and control of the trust, and these duties are performed where the trustee is resident."

Whenever important and path breaking decision like, that of St. Michael Trust is delivered, legal professionals and experts offer their comments, some recording their dissatisfaction. Human nature does not accept change easily. Even after this decision, it has been said, "*this is new judge made test of Central Management and Control. The decision means repudiation of historic test of residence of trustees to be the residence of the trust as laid down in earlier cases etc.*" One need not look for reasons which prompted the comments. However, one thing is sure that after the authoritative pronouncement, many off shore trusts with paper trustees are on a sticky wicket apprehending problems in their cases. Law, Legal issues and Legal Decisions have several facets and shades and one is entitled to look at it from his own angle.

Application of the test in India & other countries

After the above decision was rendered, I tried to find the approach of Courts in other countries on similar matters. I could find only decisions of the U.K. Special Commissioners in similar cases of trust. The Special Commissioners have considered the application of test of "place of effective management" in two decisions. In case of *Wensley Dale's Settlement vs. I.R. Commissioner*, *(1996) Spc 73,* the success of the claim of exemption from capital gains tax under avoidance scheme depended upon the fact whether the trustees of the settlement were deemed to be resident of Republic of Ireland for the reasons that they, being, "*a person other than an individual*" and resident of both Republic of Ireland and of the U.K., "its place of effective management" was situated in the Republic. The Special Commissioner considered that "effective" implies realistic positive management. On the evidence, he found that the trustee was in name

rather than in reality, signing all documents placed before her. On this basis the Special Commissioner held that place of effective management of the trust was not in the Republic of Ireland. However, similar view taken by the Special Commissioner in the other case of *Trevor Smallwood Trust vs. I.R. Commissioner* was not accepted by court of Appeal in case reported as *HMRC vs. Smallwood Trust, (2009) EWHC 777 (Ch.).* The court of appeal accepted the claim of the tax payer on the place of residence of the Trust. This case has been discussed and distinguished by courts in Canada in the case of St. Michael Trust (supra).

OECD Model Conventions

The OECD Model Conventions also support application of test of Central Management and Control to find residence of "*a person other than an individual*" as per Article 4(3) of the convention which I quote below along with Article 4(1).

> *4(1)" For the purposes of this convention, the term "resident of a contracting state " means any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence., place of management or any other criterion of a similar nature, and also includes that state and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein."*

For resolving The problem of dual residence other than an individual, it is provided as under:-

> *"4(3) Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both contracting states, then it shall be deemed. To be resident only of the state in which it's place of effective management is situated."*

The commentary on Model Convention is not of much help.

<u>Indian Position</u>

I have not been able to lay my hand on any decision of Superior Courts applying test of "Central Management and Control" to determine the residence of a trust. However, above test has been frequently applied by courts in India to determine place of residence of a Corporation when disputes arose under treaties. Reference of some cases is as under:-

In case of **Erin Estate vs. CIT [1958] 34 ITR 1**, **the Supreme Court of India** was concerned with the question of determination of residence of a firm. In that context, the court observed as under (at page 5):

> "It is true that the control and management which must be shown to be situated at least partially in India is not merely theoretical control and power, not a de jure control and power, but the de facto control and power actually exercised in the course of the conduct and management of the affairs of the firm. Theoretically, if the partners reside in India, they would naturally have the legal right to control the affairs of the firm which carries on its operations outside India. The presence of this theoretical de jure right to control and manage the affairs of the firm which inevitably vests in all the partners, would not by itself show that the requisite control and management is situated in India. It must be shown by evidence that control and management of the affairs of the firm is exercised, may be to a small extent, in India before it can be held that the control and management is not situated wholly without the taxable territories…"

A similar view has been taken in several other cases, I cite few of them.

(a) CIT vs. Nandlal Gandalal [1960] 40 ITR 1 (S.C.)
(b) CIT v. Chitra Palayakat Co. [1985] 156 ITR 730 (Mad.)
(c) Universal Cargo Carriers Inc. vs. CIT, [1994] 205 ITR 215 (Cal.)

Taxation of Trust, Trustees and beneficiaries in India

The general scheme relating to taxation of trusts, trustees and beneficiaries is similar in India as in other common law jurisdictions though statutory language of provisions may be different. The Hon'ble Supreme Court in the case of **Commissioner of Income Tax vs. Kamalini Khatau & other, (1994) 209 ITR 101 (S.C.)** explained the said general scheme. Before reference to the case is made, it is necessary to briefly refer to some relevant sections of the **Indian Income Tax Act** on the subject. These are as under:-

> Section 4 brings to "*charge"* the *'total income'* of previous year of every "*person"*. Section 5 deals with scope of 'total income' to include income (actual or deemed) received, accruing or arising to a person or on his behalf. Section 161 fixes liability of a representative assessee like an agent or a trustee of a trust. Section 164 provides to tax the trustees where shares of beneficiaries of a trust are unknown or indeterminate. Section 166 provides, alternatively direct assessment of a person on whose behalf or for whose benefit income is received by the representative assessee.

Brief facts of case of Kamalani Khatau

The tax payer in the relevant assessment year 1969-70 received some amount as beneficiary of six discretionary trusts in pursuance to the resolution of the trustees to distribute the amount out of the income of the trusts. It was claimed

that all the trusts were discretionary and the share of the assessee was indeterminate. Only trustees could be charged to tax under Section 164 of the Act. The Revenue Authorities rejected this claim and the action was upheld by the Supreme Court. In the course of their decision, the court made the following observations :-

> *“The revenue has the option to assess and recover tax from either the trustees or the beneficiaries of a discretionary trust in respect of income thereof as has been distributed to and received by the beneficiaries in the course of the accounting year."*
>
> **"Any person in effective control of income could be taxed therein, the subsequent deployment being irrelevant."**
>
> *"Even where the trustee was taxed it was the beneficial interest which was taxed. There was and could be no dispute that in case of a specific trust the Revenue could assess and recover the tax from the beneficiary even though the trustee was first recipient of the income and had legal title thereto. On a parity of reasoning, there was no impediment on taxing the beneficiary of a discretionary trust when he had received the income in the accounting year.*
>
> *"Section 164 of the Income-tax Act, 1961, does not create a charge on the income of a discretionary trust. The word "charged" in the context in which it is used in section 164 does not make the trustee of a discretionary trust liable to assessment or the recovery of tax on the income of the trust. It harks back to section161 when it refers to " persons. . . . Liable as representative assessee"*
>
> ***“No judgment (cited) stated that the income of the trust must only be assessed in the hands of the trustee.***
>
> *"Section 5 of the Act defines the total income of any person to include income received by him or received on his behalf or which accrues or arises to him. A person may be directly assessed in respect of such income. The income of a discretionary trust which is within the accounting year distributed to and received by the beneficiary would, therefore, be subject to assessment in his hands and tax therein would be recoverable from him.* ***Such income would squarely fall within the broad sweep of total income under section 5 and the beneficiary would be liable to assessment and recovery of tax therein under section 4"***

Any indication of **Common approach in two decisions** ?

One may ask what is the correlation between cases of Kamalini Khatau and of St Michael trust corporation ? The former was concerned with the question whether

a beneficiary could be taxed in case of a discretionary trust, whereas the latter dealt with the question of place of residence of a trust. The issues before two Courts were different. However, there is a similarity of thinking and legal principles applied by courts to resolve disputes in two cases. Most importantly both the courts considered in detail the relative position of trustees and beneficiaries qua trust property and its income. In the case of Kamalini, the court held that tax is to be imposed on the owner of income. In the case of St Michael, the courts recorded similar findings by applying the test of "central management and control of trusts. The beneficiaries and not the trustees, were in control (exercising rights of ownership) of trust properties. Both the courts relied upon the charging section to fix the liability to tax on the person in control of the income. There is hardly any difference between a person who is owner and the one who is exerting rights of ownership in reality. The place of residence of such person was held to residence of the trust. Thus in both the cases the approach of the courts was to find and determine the tax liability on the basis of control of properties/income of the trusts. The common legal thought pervading the two precedents would I hope some day result in a common global legal approach giving certainty to tax payer and tax administration which is also the goal of IATJ.