# The European Courts boost the Trust, at last

**The EFTA Court did it in the Olsen case in 2014[1] and now the European Court of Justice has done it again: in granting the rights of establishment and free movement of capital, trusts, the greatest wealth planning tool of all time (apart from foundations, of course), finally get the recognition they deserve, and hopefully the days of ignorance and discrimination of trusts are at an end.**

## The Case

In September 2017 the European Court of Justice, the highest court in the European Union on matters of European Union law, rendered its judgement regarding the Trustees of the P Panayi Accumulation & Maintenance Settlements v Commissioners for Her Majesty's Revenue and Customs.[2] The Panayi trustees brought proceedings before the First-Tier Tribunal (Tax Chamber) challenging the compatibility of the taxation and its immediate payment, as provided for by English tax law, with the fundamental freedoms of movement under EU law.

[1] http://www.eftacourt.int/cases/detail/?tx_nvcases_pi1%5Bcase_id%5D=211&cHash=bce3fe8b8d15b60c73fc9e74e5ea4c1b

[2] http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1508244498129&uri=CELEX:62015CJ0646

**The Facts**

The four Panayi trusts, which were governed by English law and the subject of the main proceedings, were created in 1992 by Mr Panico Panayi, a Cypriot national, for the benefit of his children and other family members. Neither Mr Panayi nor his spouse could be beneficiaries. However, Mr Panayi retained the power, as a protector, to appoint new or additional trustees. When the trusts were created, Mr Panayi, his wife and their children resided in the United Kingdom. The initial trustees of the Panayi trusts were Mr Panayi and a professional trust company established in the United Kingdom; later Mr Panayi's wife also became a trustee. In 2004 Mr and Mrs Panayi decided to leave the United Kingdom to return to Cyprus permanently. Before their departure, they both resigned as trustees. As replacements, Mr Panayi appointed new trustees, all resident in Cyprus, who joined the UK corporate trustee who had remained in office as a trustee. Accordingly, from 2004 the majority of trustees of the trusts no longer resided in the UK. Later, the UK tax authority considered that an exit tax charge had been triggered by the appointment of new trustees, since the majority of the Panayi trustees were no longer resident in the United Kingdom and, consequently, the administration of the Panayi trusts was deemed to have been moved to Cyprus.

**The Court of Justice defines Trusts**

For the first time, the Court of Justice discussed the concept and meaning of trusts, as follows: *"In common law jurisdictions, the concept of a 'trust' involves a triangular transaction, whereby the creator of the trust ('the settlor') transfers assets to a person, the trustee, who is required to deal with those assets in accordance with the instrument creating the trust ('the trust instrument') for the benefit of a third person, the beneficiary. Trusts established for the benefit of specific individuals are sometimes called settlements*." Furthermore, the Court continued that
*"the distinguishing feature of a trust is that ownership of the assets comprised in the trust is divided into legal ownership and economic ownership, the former held by the trustee, the latter held by the beneficiary. Although a trust is legally recognised and has legal effects, it has no separate legal personality and must act through the intermediary of its trustee. Assets comprised in the trust are not part of the property of the trustee. The trustee must deal with those assets as separate property, distinct from his own property. The fundamental duty of the trustee is to comply with the conditions and obligations stipulated in the trust instrument and by the law in general*."

**The Court of Justice applies the freedom of establishment on trusts**

The Court of Justice then determined whether trusts fell within the scope of the freedom of establishment. Pursuant to Article 54 TFEU, companies or firms formed in accordance with the law of a Member State and with their registered office, central administration or principal place of business within the Union are, for the purposes of the Treaty provisions relating to freedom of establishment, to be treated in the same way as natural persons who are nationals of Member States. So far, "companies or firms" as provided in the law meant companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which were non-profit-making. But would trusts qualify?

The Court of Justice held that the legislation at issue in the UK tax proceedings, for the purposes of

that legislation, held the trustees as a body, as a unit and not individually, to be liable to pay the tax due on the unrealised gains in the value of the trust's assets when that trust was deemed to have transferred its place of management to a Member State other than the United Kingdom. Such a transfer occurred when a majority of the trustees were no longer resident in the United Kingdom. The Court held that "*the activity of the trustees in relation to the trust property and the management of its assets were therefore inextricably linked to the trust itself and, therefore, the trust and its trustees constitute an indivisible whole. That being the case, such a trust should be considered to be an entity which, under national law, possesses rights and obligations that enable it to act as such within the legal order concerned.*" The Court then stressed that the trusts obviously were profit-making, as they had no charitable or social purpose and that they were created in order that the beneficiaries might enjoy the profits generated from the assets of those trusts. The Court concluded that "*an entity such as a trust which, under national law, possesses rights and obligations that enable it to act in its own right, and which actually carries on an economic activity*", may indeed rely on the freedom of establishment.

**…but justifies the restriction**

The different tax treatment was liable, as the Court continued, first, to discourage the trustees, who manage the trust, from transferring the place of management of the trust to another Member State and, second, to deter the settlor, in so far as the trust instrument permits, from appointing new non-resident trustees. That difference constituted, therefore, a restriction on the freedom of establishment. However, the preservation of a balanced allocation of powers of taxation between Member States was a legitimate objective recognised by the Court and thus justified the restriction of the freedom of establishment. However, the immediate payment of the tax, as applicable, went beyond what was necessary to achieve that objective (which the UK, in the eyes of the Court, could have achieved if its legislation made provision for the taxpayer being able to defer the time when the tax payable was paid).

**What a great day for trust practitioners! First, the European Court of Justice for the very first time applied to trusts the freedom of establishment. This will allow the trustees of trusts, including those governed by Liechtenstein law, to challenge any kind of discrimination, extending from corporate to tax law, and to defend trusts against non-recognition. Second, as only a few jurisdictions have ratified The Hague Convention on the Recognition of Trusts, this will greatly support and boost the trust concept and, in times in which trusts are sometimes, however wrongly, misunderstood to be opaque structures to hide assets for the rich, or even as "*weapons of mass injustice*",[3] it will enhance their prestige and integrity as prime wealth planning tools and "*instruments of economic progress*"[4].**

**In 2014, the EFTA Court had to decide on similar matters in the Olsen Case, but dealt *in extenso* with the question of whether the entity, or trust, conducted "*a real and genuine economic activity*" (i.e. for an indefinite period and through a fixed establishment) which was required in order to be able to benefit from the European right to establishment. By contrast, the Court of Justice appeared to simply proceed from the assumption that a non-charitable trust (or foundation) *per se* passed such a test. Further, it is quite remarkable that the Court of Justice did not expressly deal with the free movement of capital as a further pillar of European law. In the Olsen case the EFTA Court had explored the requirements of a (Liechtenstein) trust to assert such rights (e.g. if the parties did not exercise control ["*definite influence*"] over the trust), which in practice may prove quite difficult to determine. With the new Panayi case, the trustees of non-charitable trusts may easily avoid such a test as they can instead simply rely on the right to establishment.**

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[3] https://www.taxjustice.net/2017/02/13/trusts-weapons-mass-injustice-new-tax-justice-network-report/;

[4] See David Russell AM QC and Toby Graham, Trusts: Weapons of Mass Injustice or Instruments of Economic Progress, in: Trusts & Trustees, Vol 23 Issue 4 May 2017, p. 363