

Legal Issues and the Future Direction of Trust Taxation

Interaction between Trust Taxation Law and Trust Related Laws

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The taxation of trusts under Japanese income tax and inheritance tax laws began with the introduction of the "Trust Law" of 1922. The basic principles of taxation have not changed since then. These principles still apply to the taxation of trusts under the new tax law.

Under Japanese income tax and corporate tax law, if the beneficiary is specified, the gross income and expenses derived from trust property are attributed to the beneficiary as if he (the beneficiary) owns the property directly. If the beneficiary is not specified, or does not yet exist, the gross income and expenses are attributed to the grantor as if he (the grantor) owns the property directly. This is known as "beneficiary or grantor taxation." However, these taxation rules raise the possibility of unreasonable grantor taxation. Most countries following common-law trust taxation rules employ "grantor taxation" provisions only in cases involving tax avoidance. The Japanese "grantor taxation" rules seem to have a chilling effect on the use of trusts. Accordingly, we should consider adopting "trustee taxation" instead of the "grantor taxation" system.

Japanese inheritance tax law provides that if the beneficiary of a trust is different from the grantor of the trust, the beneficiary is deemed to receive the benefit of the trust at the time of the trust's creation and must pay appropriate gift or inheritance tax. This is known as the

“creation taxation” principle. However, current “creation taxation” rules may not cover all aspects of certain important trusts. Examples include trusts involving several beneficiaries or trusts which provide for successive beneficiaries at the time of creation. As a result, current trust rules must be changed to provide for useful individual trusts such as “discretionary trusts” and “interest in possession trusts.”

Integrated investment trusts are subject to special rules distinct from “beneficiary or grantor taxation” requirements. In addition, beginning in 2000, some special jointly-operated investment trusts are taxed as corporations. This allows, under certain conditions, the deduction of income distributed to investors (or beneficiaries) when calculating income. However, the tax laws addressing these provisions are complex and the basic tax theory and policy behind such rules is not clear.

Moreover, there are several aspects of individual trusts and integrated investment funds which present difficulties in the area of international taxation. Important considerations in trust taxation include the residence of the grantor, beneficiary and trustee, as well as the countries of operation of investment funds. The present tax provisions do not cover all these aspects of international trust taxation. Therefore, more detailed taxation rules are necessary to cover a wide variety of international trusts.

Finally, the circumstances surrounding the use of trusts are changing considerably. The aging of Japanese society, the reform of the financial system, and the growing global economy will each have a significant influence on the future of commercial, civil and trust law. As a result, such factors require the reexamination and amendment of the trust taxation system.