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## CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>EU DEVELOPMENTS</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>Richard Frimston and Christopher Salomons</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>THE FOREIGN ACCOUNT TAX COMPLIANCE ACT</td>
<td>27</td>
</tr>
<tr>
<td></td>
<td>Toni Ann Kruse and Michael D Shapiro</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>MODERN TRUST DESIGN</td>
<td>42</td>
</tr>
<tr>
<td></td>
<td>Todd D Mayo</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>NOTES ON THE TAXATION OF WORKS OF ART IN THE UNITED KINGDOM</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td>Ruth Cornett</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>OECD DEVELOPMENTS</td>
<td>65</td>
</tr>
<tr>
<td></td>
<td>Emily Deane</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>ARGENTINA</td>
<td>73</td>
</tr>
<tr>
<td></td>
<td>Miguel Maria Silveyra, Valeria Kemerer and Enrique López Rivarola</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>AUSTRIA</td>
<td>82</td>
</tr>
<tr>
<td></td>
<td>Paul Doralt and Katharina Binder</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>BAHAMAS</td>
<td>91</td>
</tr>
<tr>
<td></td>
<td>John F Wilson</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>BELGIUM</td>
<td>101</td>
</tr>
<tr>
<td></td>
<td>Ferenc Ballegeer</td>
<td></td>
</tr>
<tr>
<td>Chapter</td>
<td>Location</td>
<td>Authors</td>
</tr>
<tr>
<td>---------</td>
<td>----------</td>
<td>---------</td>
</tr>
<tr>
<td>10</td>
<td>BERMUDA</td>
<td>Alec R Anderson and Stephanie C Bernard</td>
</tr>
<tr>
<td>11</td>
<td>BRAZIL</td>
<td>Silvania Tognetti</td>
</tr>
<tr>
<td>12</td>
<td>CANADA</td>
<td>Margaret R O'Sullivan, Birute Luksenaite and Emma Hamilton</td>
</tr>
<tr>
<td>13</td>
<td>CAYMAN ISLANDS</td>
<td>Alan Milgate</td>
</tr>
<tr>
<td>14</td>
<td>CHILE</td>
<td>Pablo Chechilnitzky R</td>
</tr>
<tr>
<td>15</td>
<td>CYPRUS</td>
<td>Elias Neocleous and Elina Kollatou</td>
</tr>
<tr>
<td>16</td>
<td>FINLAND</td>
<td>Lauri Lehmusoja and Stefan Stellato</td>
</tr>
<tr>
<td>17</td>
<td>FRANCE</td>
<td>Line-Alexa Glotin</td>
</tr>
<tr>
<td>18</td>
<td>GERMANY</td>
<td>Andreas Richter and Katharina Hemmen</td>
</tr>
<tr>
<td>19</td>
<td>GIBRALTAR</td>
<td>Peter Montegriffo QC</td>
</tr>
<tr>
<td>20</td>
<td>GREECE</td>
<td>Aspasia Malliou and Maria Kilatou</td>
</tr>
<tr>
<td>21</td>
<td>GUERNSEY</td>
<td>Keith Corbin and Mark Biddlecombe</td>
</tr>
<tr>
<td>22</td>
<td>HONG KONG</td>
<td>Ian Devereux and Silvia On</td>
</tr>
</tbody>
</table>
Chapter 23  HUNGARY
Janos Pasztor

Chapter 24  ISLE OF MAN
Craig Brown

Chapter 25  ITALY
Nicola Saccardo

Chapter 26  JAPAN
Masayuki Fukuda and Yushi Hegawa

Chapter 27  LIECHTENSTEIN
Markus Summer and Hasan Inetas

Chapter 28  LUXEMBOURG
Simone Retter

Chapter 29  MALAYSIA
DP Naban, SM Shanmugam, Ashley Lee Si Han, Heng Jia and Christine Lay Kei Een

Chapter 30  MALTA
Jean-Philippe Chetcuti and Priscilla Mifsud Parker

Chapter 3  MEXICO
Edgar Klee Müdespacher and Joel González Lopez

Chapter 32  NEW ZEALAND
Geoffrey Cone and Claudia Shan

Chapter 33  POLAND
Slawomir Łuczak and Karolina Gofryd

Chapter 34  PORTUGAL
José Pedroso de Melo

Chapter 35  SPAIN
Pablo Alarcón

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<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>36</td>
<td>SWITZERLAND</td>
<td>403</td>
</tr>
<tr>
<td></td>
<td><em>Mark Barmes, Frédéric Neukomm and Heini Rüdisühl</em></td>
<td></td>
</tr>
<tr>
<td>37</td>
<td>UNITED KINGDOM</td>
<td>416</td>
</tr>
<tr>
<td></td>
<td><em>Christopher Groves</em></td>
<td></td>
</tr>
<tr>
<td>38</td>
<td>UNITED STATES</td>
<td>429</td>
</tr>
<tr>
<td></td>
<td><em>Basil Zirinis, Katherine DeMamiel, Elizabeth Kubanik and Susan Song</em></td>
<td></td>
</tr>
<tr>
<td>Appendix 1</td>
<td>ABOUT THE AUTHORS</td>
<td>447</td>
</tr>
<tr>
<td>Appendix 2</td>
<td>CONTRIBUTING LAW FIRMS’ CONTACT DETAILS</td>
<td>469</td>
</tr>
</tbody>
</table>
I INTRODUCTION

As I reflect on the developments of the last 12 months, the overriding theme is that of continuing regulatory change in the private wealth arena. A sense of increasing pace and convergence in particular stand out in comparison with earlier years.

The pace component is best seen in the introduction of new regimes or the updating of existing rules. The theme of convergence is based upon how centrally significant the concept of 'beneficial ownership' is becoming to many of the initiatives. A third strand is an increasing divergence between the European Union and the United States in this arena: the European Union continues to force the pace on transparency, while the United States proceeds at a much more leisurely speed and gives greater weight to privacy concerns than its European neighbours.

Clients whose assets are fully declared and are in compliance with their tax obligations are becoming increasingly sensitive to the massive complexity and increased regulatory burden that falls upon service providers and the attendant costs that they are obliged to meet. This is leading to a mindset in which additional elements of complexity in asset-holding structures are being viewed with a greater degree of scepticism. In some cases, it is also leading to a review as to whether existing structures, whether trusts or holding companies, are still the best means of achieving the family’s objectives and warrant additional cost and regulation.

While these compliant families fully understand the need for transparency to tax and regulatory authorities, there is growing concern about the pressure for public disclosure in the context of beneficial ownership registers when the disclosure relates not to businesses that trade and engage with the public at large, but to family asset-holding structures.

A review of the preamble to the EU’s Fifth Anti-Money Laundering Directive (5 AMLD) shows that, while apparent lip service is paid to respecting an individual’s right to privacy, the argument that greater public or quasi-public access to information with respect to many private asset-holding structures is required to combat the fight against terrorism and money laundering appears to hold sway. The fact that any private asset-holding structure of this type will be obliged to provide comprehensive and detailed beneficial ownership information to regulated service providers such as banks, trust and corporate service providers, legal advisers and accountants is not regarded as sufficient by EU policymakers.

5 AMLD also exemplifies a mindset in which those whose family structures (such as trusts and foundations) are managed outside the EU are subjected to a greater degree of transparency than for EU-managed structures. The rationale for this approach is that, as non-EU jurisdictions have not embraced the same degree of transparency for corporate
registers, it is necessary to render the entities that hold assets with an EU connection, such as real estate, or those with an ongoing EU ‘business relationship’, to public scrutiny. I deal with this in greater depth below.

Tax authorities have been swift to fasten onto the increased scope of these measures. While fighting terrorism and drug-smuggling was their original purpose, they have enabled tax authorities to widen the net of information that is collected and reported on citizens who are neither terrorists nor drug barons but who hold significant wealth in complex asset-holding structures.

In the rest of this foreword, I will consider two specific areas:

a. the Organisation for Economic Co-operation and Development (OECD)’s revised Common Reporting Standard (CRS) Commentary with a focus on trust guidance; and

b. the wide-reaching implications of the EU’s 5 AMLD and the meaning of ‘control’ in a trust context with regard to UK and Maltese trust registers.

1. CRS Revised Handbook (April 2018) with a focus on the amendments to trust guidance

CRS applies to trusts when:

a. a trust is a reporting financial institution (RFI); or

b. a trust is a passive non-financial entity (NFE) that maintains an account with an RFI.

One of the key issues under discussion under the CRS and the first version of the CRS Commentary was the status of ‘protectors’.

The CRS framework provides for reporting in the context of trustees who are RFIs to be made of persons who are treated as having an ‘equity interest’ in the trust fund. In this context, Section VIII.C.4 of the CRS states that an equity interest is held ‘by any person treated as a settlor or a beneficiary of all or a portion of the trust or any other natural person exercising ultimate effective control over the trust’.

By contrast, in relation to a trust that is a passive NFE, it is necessary to identify controlling persons in relation to the trust. In the CRS, Section VIII D.6 defines ‘controlling person’ on the basis that the expression is intended to correspond to the term ‘beneficial owner’ as described in Recommendation 10 and the interpretative note on Recommendation 10 of the Financial Action Task Force (FATF) guidance as adopted in February 2012. In the case of a trust, controlling persons means ‘settlor, the trustees, the protector (if any), the beneficiary or class of beneficiaries and any other natural person exercising ultimate effective control over the trust’.

In its FAQ issued in June 2016, the OECD took the position that, where a trust is an RFI, a protector ‘must be treated as an account holder irrespective of whether it has effective control over the trust’. This response does not address the clear distinction in the CRS itself between the holders of equity interests in a trust that is an RFI (which only includes protectors if they actually exercise ultimate effective control; see above) when contrasted with the ‘controlling persons’ definition of a trust that is a passive NFE (which includes protectors regardless of the powers they hold; see above).

The Secretariat of the OECD previously confirmed that it is their intention that protectors of trusts that are RFIs should be reported, and the FAQ was discussed in and approved by the relevant working party of the OECD.
The second version of the Commentary has amended Paragraph 253 to read:

*The Equity Interests are held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust. The reference to any other natural person exercising ultimate effective control over the trust, at a minimum, will include the trustee and the protector as an Equity Interest Holder.*

Until the legal basis for this is made clear in the CRS treaty itself, it is considered that there is a reasonable basis for forming the opposite conclusion.

The new Commentary also provides further clarity on what reporting is required when an account is closed or a beneficiary removed:

Where an account is closed during the year, the fact of closure is reported (in addition to any distributions made prior to closure). A debt or Equity Interest in a trust could be considered to be closed, for example, where the debt is retired, or where a beneficiary is definitely removed.

The other main amendments to the Commentary relate to the obligation to look through equity interest holders and controlling persons, which are themselves entities. Paragraph 256 has been amended to read:

*Where an Equity Interest (such as the interest held by a settlor, beneficiary or any other natural person exercising ultimate effective control over the trust) is held by an Entity, the Equity Interest holder will instead be the Controlling Persons of that Entity. As such, the trust will be required to look through a settlor, trustee, protector or beneficiary that is an Entity to locate the relevant Controlling Person. This look through obligation should correspond to the obligation to identify the beneficial owner of a trust under domestic AML / KYC procedures.*

The new Commentary notes that, in looking through entities,

*The Controlling Persons of Passive NFE are defined in the CRS as natural persons exercising control over the Entity. The CRS definition of the term Controlling Person corresponds to the term beneficial owner as set out in Recommendation 10 and the accompanying Interpretative Note of the 2012 FATF Recommendations.*

*The identity of beneficial owner of a legal person is defined as any natural person who ultimately has controlling ownership interest which is usually defined on the basis of a threshold. Footnote 30 to the Interpretative Note to Recommendation 10 of the 2012 FATF Recommendations (as printed in March 2012) gives an exemplary ownership threshold of 25%.*

1 Emphasis added.
2 Emphasis added.
3 Emphasis added.
Although, earlier in the Commentary it notes that:

> It is important to point out that the ownership threshold for legal persons of 25% that is specified in footnote 30 in the Interpretative Note to Recommendation 10 of the 2012 FATF Recommendations (as printed in March 2012) is only indicative.

> Should the ownership structure analysis result in doubt as to whether the person(s) with the controlling ownership interest are the beneficial owners or where no natural person exercises control through ownership interest the analysis shall proceed to identifying any other natural person(s) exercising control of the legal person through other means. As a last resort, if none of the previously mentioned tests result in identification of the beneficial owner(s), the senior managing official(s) will be treated as the beneficial owner(s).

Various examples are given on how to look through entities. Unfortunately, the new Commentary does not cover more complex structures that had previously been raised with the OECD, such as where a purpose trust owns a private trust company.

### ii Trust registers: implications of 5 AMLD and the meaning of ‘control’

The key text for 5 AMLD was published in December 2017 and endorsed by a legislative resolution of the European Parliament on 19 April 2018. It was then adopted by the EU Council on 14 May 2018. On 19 June 2018, the text for 5 AMLD was then published in the Official Journal of the European Union. EU Member States must transpose 5 AMLD into their national law by 10 January 2020.

#### Enlarged scope of registration

4 AMLD limits the scope of trusts requiring registration on a domestic trust register in the relevant EU Member State to those that generate tax consequences; 5 AMLD widens this scope to all trusts that ‘reside or are established’ in the Member State concerned. It also applies to fiducie, treuhand or fideicomiso as well as to foundations (which fall within the concept of legal arrangements). In practice, in the case of trusts, this will be the place where the trustee resides and not referenced to the governing law of the trust itself.

#### Non-EU resident trusts: registration

There is a requirement for non-EU resident trusts to register in two instances. The proposed new Article 31(3a) of 5 AMLD, for a trust established or residing outside the European Union, reads:

> Member States shall require that the beneficial ownership information of express trust and other types of legal arrangements when having a structure or functions similar to trusts shall be held in a central beneficial ownership register set up by the Member State where the trustee of the trust or similar legal arrangement is established or resides.
Where the place of establishment or residence of the trustee of the trust or similar legal arrangement is outside the Union, the information referred to in paragraph 1 shall be held in a central register set up by the Member State where the trustee enters into a business relationship or acquires real estate in the name of the trust or similar legal arrangement.  

On business relationships, the existing text of Article 3(13) of 4 AMLD, which is not amended by draft 5 AMLD, states: ‘a business relationship means a business, professional or commercial relationship that is connected with the professional activities of an obliged entity and which is expected, at the time when the contact is established, to have an element of duration.’

It is unclear what these words mean in practice. In the broader sense, they could be taken to include sourcing professional advice from a counterparty in an EU Member State. It is understood that the intent at the time 4 AMLD was finalised was to focus on ‘business trusts’. The European Union was informed at the time by STEP and other commentators that this expression did not have any well-established meaning given that the vast majority of business activity conducted in a trust context would, for reasons of liability protection, be conducted through the mechanism of underlying companies. It remains to be seen what sort of guidance will be provided on this topic. If given a wide meaning, it could mean any use of professional advisers for legal, tax accounting or investment advice within the EU could trigger a requirement to register.

So far as the acquisition of real estate is concerned, it would seem this is confined to situations of EU real estate held at the trust level alone and not where such real estate is held via an underlying entity.

The regulations make provision to allow a trust to provide evidence of registration in one Member State through a ‘certificate of proof of registration or an excerpt . . . of the register’ to avoid the need for duplicated registration.

Public access

5 AMLD allows for a modified form of public access to the trust register by ‘persons who are able to demonstrate a legitimate interest with respect to money laundering, terrorist financing, and the associated predicate offences, such as corruption, tax crimes and fraud’.

At present, there is no clearly understood meaning as to what constitutes ‘legitimate interest’. The implications of the 5 AMLD preamble are, however, that NGOs and investigative journalists with anti-corruption profiles should normally be seen as being able to assert a legitimate interest. This may well be a matter where different EU jurisdictions take a variety of approaches.

There is also a requirement to interlink the various EU registers by 2021, and a requirement to provide mechanisms for the verification of data. The absence of any verification mechanism to date has been seen as a major limiting factor in the utility of beneficial ownership registers. How this verification will be policed is unclear.

The qualified public access on the basis of legitimate interest needs to be contrasted with circumstances where full public access is proposed. This is in the case of use of a non-EU holding company by a trust that either resides in an EU Member State or, it would seem, becomes registrable as a result of an EU business relationship or holding of EU real estate as noted above.

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4 Emphasis added.
Article 31(4) of 5 AMLD considers the situation for trusts owning a controlling interest in a non-EU company:

The central register shall ensure timely and unrestricted access by competent authorities and FIUs, without alerting the parties to the trust concerned. It may also allow timely access by obliged entities, within the framework of customer due diligence in accordance with Chapter II. Member States shall notify to the Commission the characteristics of those national mechanisms to ensure that the information on the beneficial ownership of a trust or a similar legal arrangement is accessible in all cases to:

a. competent authorities and FIUs, without any restriction;

b. obliged entities, within the framework of customer due diligence in accordance with Chapter II;

c. any person or organisation that can demonstrate a legitimate interest;

d. any person that files a written request in relation to a trust or similar legal arrangement which holds or owns a controlling interest in any corporate or other legal entity other than those referred to in Article 30(1), through direct or indirect ownership, including through bearer shareholdings, or through control via other means.\(^5\)

Article 30(1) is the requirement for EU companies to maintain a public register of beneficial owners. Thus, for all non-EU companies, any person can, on written request, obtain information on an EU-resident trust that controls it. It is understood at this stage that privacy may be afforded to EEA-resident companies that maintain a public register. This would mean Liechtenstein companies may not fall within the scope of sub-paragraph (d) as it is an EEA member.

It is not clear how an individual would in the first instance learn of the existence of a trust in these circumstances. There is also no recognition in these rules that non-EU companies may be subject to any form of public beneficial ownership register in their own jurisdiction (given the UK’s recent proposals to extend public registers of corporate entities to its overseas territories).

### iii The UK’s position: Brexit transition

A recent UK parliamentary report stated:

Although these dates all fall after the UK’s projected exit from the EU in March 2019, it now appears likely the Government will agree to a post-Brexit transitional period during which EU law would continue to apply in the UK as if it were still a Member State. In those circumstances, the new AMLD would have to be implemented if its transposition dates occur within that period (which, considering the Prime Minister has said the transition is likely to be “around two years”, is likely to be the case for all three types of register).

It is therefore anticipated, given the imminent application of 5 AMLD, that the United Kingdom will be obliged to comply with it, at least during the transitional period. Given that the United Kingdom has also been within the vanguard of transparency initiatives with its European neighbours, it would be unsurprising if it continued to apply 5 AMLD in some

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\(^5\) Emphasis added.
form once the Brexit transition has concluded. Whether the public access component for trusts would be watered down remains to be seen. It is understood that the Labour Party advocates full public access to the UK trust register.

It is also unclear whether UK companies will be regarded as ‘non-EU’ for this purpose post-Brexit, but it is assumed they will be regarded as equivalent.

iv Meaning of ‘control’ in the context of EU trust registers

FATF 2012 Recommendations: Recommendations 10, 24 and 25 require trustees and financial institutions to identify ‘the ownership and control structure of the customer’. I now turn to the two examples of trust registers in the EU that have been implemented under 4 AMLD, the forerunner to 5 AMLD. This throws an interesting light upon the extraordinary width of whom should be regarded as a beneficial owner in the context of a trust.

Section 5(2) of the UK’s Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, which came into force on 26 June 2017, require that trustees register:

a. a settlor;
b. trustees;
c. named beneficiaries;
d. beneficiaries who have received a distribution from the trust; and
e. anyone who exercises ‘ultimate control’ over the management of the trust.

Section 2(1)(e) Malta’s Trusts and Trustees Act (Register of Beneficial Owners) Regulations (the RBO Regulations), which came into force on 1 January 2018, require that trustees register:

a. a settlor;
b. trustees;
c. named beneficiaries;
d. a protector; and
e. anyone exercising ‘ultimate and effective control over the trust by any means’, including any other person:

- whose consent is to be obtained; or
- whose direction is binding in terms of the terms of the trust instrument or of any other instrument in writing, for material actions to be taken by the trustee.

FATF 2012 Recommendation 10: financial institutions must identify ‘any other natural person exercising ultimate effective control over the trust’.

In the context of the EU’s 4 AMLD and the trust register, Her Majesty’s Revenue and Customs have stated that ‘control’ means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to:

a. dispose of, advance, lend, invest, pay or apply trust property;
b. approve proposed trust distributions;
c. vary or terminate the trust;
d. add or remove a person as a beneficiary or to or from a class of beneficiaries;
e. appoint or remove trustees or give another individual control over the trust; and
f. direct, withhold consent to or veto the exercise of a power mentioned above.
In the context of the 4 AMLD and the beneficial ownership register for trusts, Malta’s RBO Regulations have stated that ‘control’ means anyone exercising ‘ultimate and effective control over the trust by any means’, including any other person whose consent is to be obtained; or whose direction is binding in terms of the terms of the trust instrument or of any other instrument in writing, for material actions to be taken by the trustee.

The definition of ‘material actions’ means the following actions or any other actions achieving the same result:

- the amendment of the trust instrument;
- the addition or removal of any beneficiary, or any person from a class of beneficiaries, or any action affecting the entitlement of a beneficiary;
- the appointment or removal of trustees or protectors or to give another individual control over the trust;
- the acceptance of an additional settlor as may be applicable in terms of the terms of the trust instrument;
- the change of the proper law of the trust; and
- the assignment or transfer of all or most of the assets of the trust or the termination or revocation of the trust.

CRS imports into the concept of ‘controlling persons’ a direct link to the FATF defined terms of ‘beneficial owners’. The CRS Commentary states at Paragraph 132:

> Subparagraph D (6) sets forth the definition of the term ‘Controlling Persons’. This term corresponds to the term ‘beneficial owner’ as described in Recommendation 10 and the Interpretative Note on Recommendation 10 of the Financial Action Task Force Recommendations (as adopted in February 2012), and must be interpreted in a manner consistent with such Recommendations, with the aim of protecting the international financial system from misuse including with respect to tax crimes.6

On this basis, it is highly likely that the expanded definition of control that is implicit in the UK and Maltese trust registers in an anti-money laundering context that flows from the FATF 2012 framework will, over time, result in more significant disclosure being required in a CRS tax information exchange context. This is an example of the aforementioned convergence theme (see Section I).

As a separate matter, the FATF has recently been reviewing the 2008 Guidance to Trust and Corporate Service Providers. It is possible that the amended text will also give more detailed guidance on the meaning of a ‘natural person exercising effective control’ in a trust context. This will have a direct impact on CRS reporting for trusts in the light of the linkage mentioned above in the CRS model treaty.

The significant extensions are most likely to impact influence exercised:

- by committees where, to date, it has been argued that no one individual can personally decide upon a course of action;
- in an indirect manner by a family individual who does not serve as a protector as such but instead has a power to appoint or remove protectors; and
- by those with negative ‘veto’ powers but without positive powers to decide upon specific matters that impact the relevant trust.

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6 Emphasis added.
It could be timely, therefore, for advisers to consider whether current governance arrangements for the oversight of trusts are still ‘fit for purpose’ or not.

II CONCLUSION

What can be said at this stage is that advisers must continue to keep themselves informed on the important changes to the regulatory and transparency arena. There is no sign that the pace of reform is slowing at this point, quite the opposite.

In the longer term, it remains to be seen whether the degree of transparency and attendant public disclosure that the EU has embraced will be adopted more widely in the rest of the developed world. It is clear that the United States has been much slower to adopt measures that override privacy in such a sweeping manner.

John Riches
RMW Law LLP
London
August 2018
EU DEVELOPMENTS

Richard Frimston and Christopher Salomons

I INTRODUCTION

The European Union has been a structure under stress, facing significant change, for many years. Its development from the European Coal and Steel Community into the European Economic Community, then to the European Community and now the European Union, was one of incremental steps. It was perhaps the fall of the Berlin wall, the reunification of Germany and addition of many more Member States after 1990 that was the catalyst for many of the strains it faces today. Its competence, in relation to taxation, has in the past been limited to the European sales tax, namely value added tax (VAT). The problems with the single currency – the euro – wax and wane, and concerns as to Greece’s place in it have now been replaced by those of Italy. Its structural difficulties remain currently unchanged and it remains to be seen whether France and Germany can find any acceptable common ground for its reform. Further, the referenda in Denmark and the United Kingdom demonstrated a general unhappiness of EU citizens with its direction of travel. Recent trends in Italy, Austria and the Visegrád Group of Poland, Hungary, Slovakia and the Czech Republic are seen as representing a sea change from the liberal social democratic model of the majority of Member States. And although the overall improving economic outlook and 2017 election results in the Netherlands and France, in which right-wing anti-EU parties were defeated, gave the European Union and its various institutions hope that a corner had been turned, the 2018 Italian election results were a clear rebuke to this.

All Member States continue to be focused on economic growth, debt reduction and maximising tax collection, particularly from corporations, while dealing with their citizens’ concerns over immigration. EU institutions are conscious of the overwhelming priority to maintain the euro as a single currency and produce economic growth, notwithstanding global headwinds, and the Eurozone perspective and priorities continue to drive these Member States towards ever closer union. Further, relations with the United States are now strained. The United States’ support of NATO can no longer be taken for granted and the German Chancellor Angela Merkel’s statements as to the future of Europe being separate from the United States and United Kingdom indicate that geopolitics may also push EU Member States closer together. Moreover, the United States’ wish to renegotiate the Paris Agreement, its tariffs on steel and aluminium, and disdain for the G7, has all given China an opening to be seen to stand with the European Union.

Uncertainties in Ukraine and with Russia moved the Baltic States firmly into the euro, in contrast to the non-euro Member States such as the Czech Republic, Sweden and Poland,
who remain firmly outside. The two-tier eurozone/non-eurozone EU already creates significant tensions. Stark divisions in the United Kingdom, which were exacerbated by its referendum, would have objectively been expected to lead to a call for some form of compromise, but have instead resulted in considerable paralysis. The EU is particularly frightened of contagion and other dominoes falling. Brave political leadership may be in short supply, but other differences over and above that of the euro are, in any event, producing a more complex and multilayered EU.

While strictly not a federation, at many levels the European Union behaves like one. Since the Lisbon Treaty of 2009, the Treaty on European Union and the Treaty on the Functioning of the European Union govern its constitution and legislative processes. The relationship between its civil service (the Commission), the Member States’ governments (the Council of Ministers) and the European Parliament is still a work in progress. The results of the European Parliament elections, held in May 2014, although producing generally anti-EU results in the United Kingdom and France, had been taken as a vote for business as usual by Parliament, which is flexing its muscles, particularly in the area of tax. In the field of anti-money laundering and tax evasion, the Commission appears to be siding with an increasingly vocal Parliament rather than with the Council of Ministers. For the May 2019 European Parliament elections, 27 of the United Kingdom’s 73 seats will be apportioned to other Member States (in particular, France, Spain, Italy and Ireland), with an overall reduction of 46 seats from 751 to 705. However, there is no evidence that Parliament (or the Commission) has taken on board the implications of the more complex EU forces at work.

Even when reduced to 27 Member States, the European Union is a place of significant wealth. With a combined population of 510 million, just under 7 per cent of the world’s population, it has approximately 22 per cent of the world’s GDP and is its second-largest economy. The European Economic Area (EEA) consists of the European Union, Iceland, Liechtenstein and Norway (Switzerland being a member with Iceland, Norway and Liechtenstein of the European Free Trade Association but not in the EEA). Whether, in the future, the United Kingdom rejoins the EEA (or the European Union, for that matter) is an open question.

The economic prosperity of the EEA made it an increasingly attractive destination for those fleeing conflict and poverty to its south and east. If the United Kingdom exits the European Union, even if it remains in the EEA, the strength and prosperity of both the United Kingdom and the EEA are likely to be diminished.

Adding to these tensions are the problems associated with mass migration. The 2016 referendum in the United Kingdom as to whether it should remain in the European Union and subsequent serving of Article 50 notice to leave in March 2017 cast something of a shadow over the workings of the European Union, but is probably now somewhat down its list of priorities. The migration of both EU and non-EU nationals to the wealthier parts of the European Union brings its fundamentals into sharp focus. The free movement of labour and capital was designed to produce economic growth for both Member States and business. The demographics of most Member States require immigration to feed economic growth and counter falling birthrates. However, mass migration is an issue for all front-line Member States, such as Italy, Malta and Greece, and is also one for indigenous citizens who perceive

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2 http://europa.eu.
that their own wages and standard of living are being reduced by the competitive market. In practice, most Member States have quietly found ways to limit freedom of movement, particularly for those not in employment.

In 2016 and 2017, France, Germany and the United Kingdom all suffered from highly publicised terrorist attacks. Being seen to deal with such threats effectively, while maintaining European traditions of tolerance and freedom, gave EU governments common problems and reasons to work together. However, memories quickly fade, and the political pressure for unity in the European Union always overrides any calls for cooperation with third-party states. EUROPOL and the Galileo project are examples of issues where the European Union cannot treat the United Kingdom as a special case.

However, against a backdrop of continuing security threats, it is unlikely that the European Union, its Member States and the EEA will be easily able to square the circle in relation to mass migration and economic growth. Freedom of movement will likely be quietly further curtailed.

II UNITED KINGDOM

The United Kingdom, which has been on the brink of a constitutional crisis in relation to Scotland and to a lesser extent Wales for some time, currently faces multiple potential political crises. The September 2014 referendum in Scotland as to whether Scotland should be independent, focused considerably on the continuing nature of the strange ragbag of arrangements between the UK government in Westminster and those in Scotland, Wales and Northern Ireland. Northern Ireland, a product of its history and geography, is also caught between numerous forces, with signs that its recent peace accord has perhaps been taken for granted. London, while having a larger population than each of those jurisdictions, has limited local government, while England as a whole has none.

Further, the United Kingdom’s 2017 snap general election result, which produced no clear winner, came as a surprise to many. But the rise of the Conservative Party in Scotland in protest at the one-party Scottish Nationalist Party, which is the ruling governing party in the devolved national parliament of Scotland, should not have done. The Labour Party ran a far more effective and optimistic campaign, while the Conservative Party was, in general, blamed for calling an unnecessary election and asking voters to give it a blank cheque. They declined to do so. It would seem that many electors voted against a party rather than necessarily for one.

The timetable for Brexit is ticking and politicians are only now addressing the extremely difficult and complex fundamental questions that should have been considered before the EU Referendum rather than after Article 50 had been triggered.

The narrow margin of 4 per cent on a 73 per cent turnout in the UK’s EU Referendum has left the country completely divided, and the 2017 general election has not healed these divisions. London and Scotland, by a 20 per cent majority, and Northern Ireland by a smaller one, voted to remain in the EU. The remainder of England and Wales, with the exception of some cities, such as Bristol, Liverpool and Oxford, voted by a significant majority to leave. The population and the main political parties are still riven by the question of the EU. Prime Minister Theresa May has surprised many by remaining in office, perhaps because any other leader would be more divisive. The Conservative Party does not currently show any sign of finding a way out of the quagmire it has got itself into. The Labour Party has also been divided by Brexit, but is now perhaps beginning to campaign against its downsides by labelling it ‘the Tory Brexit’. Transitional arrangements, if agreed, are likely to last beyond December 2020.
Most English politicians, whether on the left or right, feel constrained by the result of the referendum. The negative economic effects and unpalatable political choice of either no deal or otherwise membership of the EEA have created the current political stasis. The Irish question adds further historical and current complications. The Scottish question has also not been fully resolved.

EU institutions have seen the referendum as an unnecessary distraction. The United Kingdom had previously been seen as a pragmatic and effective major EU Member State, but is currently seen as a laughing stock that is shooting itself in the foot, if not the head, and without any clear realistic vision as to its future. Whether it will have a government able to follow through any negotiations and enact any necessary treaty arrangements is still seen as questionable. The consequent downsides for the European Union have not been openly discussed. The necessary reductions in EU income are unlikely to result in reductions in spending, and current proposals to move economic support from the east to the south of the European Union would create both winners and losers. The exercise of raw political power may not be pretty.

The loss of a major common law state will leave a more homogeneous civil law European Union, a less open market and will leave the European Union less outward-looking. It will be the poorer for it.

The UK government and its institutions have been expending virtually all of their energy in negotiating with the European Union and attempting to resolve the effects of its exit from the European Union on its laws and structures, while being blown and buffeted by events. This will surely continue for many years to come. While the absence of a written constitution has enabled flexible and incremental change in the United Kingdom, all of these tensions will continue to create mounting pressure for some new relationships between the various existing UK structures. In the meantime, it is very likely that the United Kingdom and EEA economies will decline, while at the same time the proportion of UK government spending will inevitably increase.

### III TAX

Generally, the EU has had no competence over personal taxation for individuals, such matters being for individual Member States and outside its competence. However, with increasing frequency, the Court of Justice of the European Union (CJEU) has held that the right to free movement of persons, goods, services and capital within the EU applies to limit the taxation rights of Member States. Inheritance was found to be a movement of capital and many Member State governments have been forced to amend existing tax rules. In the case of Austria, this led directly to the abolition of gift and inheritance tax.

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3 In, for example, Case C-364/01 Barbier [2003] ECR I–15013 (treatment of immovable property); Case C-513/03 van Hilten-van der Heijden [2006] ECR I–1957 (inheritance tax within 10 years of being resident was permissible); Case C-464/05 Geurts [2007] ECR I–9325 (exemption for Belgian businesses only); Case C-256/06 Jäger [2008] ECR I–123 (reduction for German agricultural property only); Case C-1107 Eckelkamp [2008] ECR I–6845 (reductions for Belgian residents only); Case C-43/07 Arens-Sikken [2008] ECR I–6887 (provisions for Dutch residents only); Case C-67/08 Block [2009] 2 CMLR 39 (double taxation by Spain and Germany was permissible); Case C-510/08 Mattner [2010] All ER (D) 167 (Apr) (exemptions for German residents only); Case C-133/2013 re Q (restriction of exemption to Dutch land was permissible); and Case C-682/2017 Panayi (taxation of trusts leaving the United Kingdom).
As a result, the EU Commission looked at two separate initiatives:

a. the effects of inheritance taxes on the rights of free movement; and
b. double non-taxation.

The limited competence of the EU in these areas has, however, meant that the recommendations were advisory only.

Over the years, the EU has developed various cross-border structures such as the European Company (SE) and the now-lapsed proposal for a European Foundation (FE). However, the tax treatment of these structures is not uniform. There has as yet been no proposal for an EU-wide tax transparent vehicle such as an LLC, LLP or SCI.

By contrast, the EU has concentrated much firepower on corporate taxation. There is broad consensus on the part of EU institutions, Member States and the Organisation for Economic Co-operation and Development (OECD) on tackling aggressive tax planning by corporations. Tax justice and a level playing field are seen as a priority. The EU Commission has presented its Action Plans for Fair and Efficient Corporate Taxation in the EU and has relaunched the Common Consolidated Corporate Tax Base.

The proposed EU–US Transatlantic Trade and Investment Partnership, the main goal of which was to remove regulatory ‘barriers’ that restrict the potential profits to be made by transnational corporations on both sides of the Atlantic, is now seen as a dead duck. The EU–Canadian agreement, however, was finalised in the EU Parliament in February 2017, subject to ratification by national legislatures. This can no longer be assumed to be automatic. Belgium in the past, and now Italy and perhaps the Visegrád Four, may put a spoke in the wheel. The European Union appears to be making good progress with free-trade agreements with Japan and Australia. Further legislation continues to be made. The Regulation on Mutual Recognition of Protection Measures in Civil Matters came into force in January 2015 and binds the United Kingdom and Ireland, but not Denmark. The Brussels I Regulation was reviewed and amended: Brussels I bis came into force in January 2015. The Brussels II bis Regulation has been under review and is about to be finalised. The European Union (now including Denmark), Mexico and Singapore have ratified Hague 37 on choice of court agreements that entered into force on 1 October 2015. It applies in Ireland (and the UK).

Rome IVa (EU) 2016/1103, dealing with matrimonial property and Rome IVb (EU) 2016/1004, dealing with the property effects of registered partnerships came into force on 29 July 2016 and will become fully effective on 29 January 2019, but were Regulations subject to enhanced co-operation and will only apply in 18 Member States. This is dealt with in more detail below.

Regulation (EU) 2016/1191 of 6 July 2016 on promoting the free movement of citizens by simplifying the requirements for presenting certain public documents in the European Union was not subject to any opt out by the United Kingdom or Ireland and will become fully effective on 16 February 2019.

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6 Regulation No. 1215/2012 (recast) effective from 10 January 2015, replaced Regulation No. 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters of 22 December 2000.
How the United Kingdom is to extract itself from the EU *acquis*, built up over 40 years, is not straightforward. The proposed transitional arrangements on judicial cooperation in civil and commercial matters, suggested by the EU Commission Task Force,\(^9\) are very sensible but highlight the practical difficulties and complexities of disengagement.

IV TAX COLLABORATION, ENFORCEMENT AND REGULATION

Although the European Union is not a fully functioning federal state, its role in world organisations such as the OECD and the Financial Action Task Force (FATF) over money laundering and fraud or the Hague Conference over private international law, and in negotiating with world powers such as the United States in relation to matters such as the Foreign Account Tax Compliance Act (FATCA), should not be underestimated.

The European Union data protection laws appear to be what forced the United States into its FATCA Model 1 agreements with Member States.\(^10\) The European Commission played a significant role in those negotiations. However, while the Commission hoped to introduce a European FATCA, this was not politically acceptable in all Member States. The former Savings Tax Directive is now dead and is likely to be repealed.

In parallel, however, the OECD developed its Common Reporting Standard (CRS), which seems to have been accepted by the European Union as the model for automatic tax information exchange and brought to an end further changes to the Savings Tax Directive. There seems to be, however, no realistic prospect of the US abandoning FATCA in favour of the CRS at the moment.


Money laundering directives were originally introduced to counter terrorist activity. Tax evasion and ‘abusive’ tax avoidance are now increasingly in the sights. The proposals for registers of beneficial interests in companies inevitably led to strong calls from Parliament for registers for trusts and beneficial interests. The Fourth Anti-Money Laundering Directive (EU) 2015/849, came into force on 26 June 2015 and should have been implemented in each Member State by 26 June 2017. Article 31 imposes different obligations on the trustees of express trusts to the obligations imposed in relation to beneficial ownership information required for legal entities under Article 30.

The Panama Papers and other calls from NGOs resulted in the Commission and Parliament very quickly revisiting the effectiveness of the Fourth Anti-Money Laundering Directive. The ever-increasing demand, particularly from journalists and various NGOs, for public registers of beneficial ownership in relation to all structures in all jurisdictions

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\(^10\) The starting point for all US FATCA Model 1 Agreements.

has clearly influenced EU institutions. The Fifth Anti-Money Laundering Directive (EU) 2018/843 was enacted into law on 9 July 2018,\(^\text{12}\) and is to be implemented in each Member State by 10 January 2020. It extends the reporting obligations, but leaves it to Member States to decide how public the registers are to be. It is likely that the United Kingdom will implement it in part, if not in full. The EU Parliament Report from the Committee on the Panama Papers inevitably called for full open registers and focus on financial intermediaries. Since 1 March 2018, this has now metamorphised into the special committee on financial crimes, tax evasion and tax avoidance (TAX3).\(^\text{13}\)

Since Henry VIII’s attempt to tax the use, equity has been successful in adapting and evolving to meet the demands modern society placed on it. Equity’s success is perhaps now under attack, particularly from the civil law world and civil society that sees it as a hindrance against corruption and tax fairness. It will be interesting to see how equity develops in response. Whether the United Kingdom will pull back from some EU developments when it leaves the European Union is yet to be seen.

Practitioners therefore face continuing change, multiple registration and compliance obligations and public pressure for transparency, all of which will push up the costs of practice.

V \hspace{1em} SUCCESSION AND MATRIMONIAL PROPERTY

It is in the area of succession law that the EU demonstrates its particular complexities. The substantive laws in Member States vary considerably in all areas. Individual forms of wills and succession agreements vary, as do the rules on forced heirship and reserved portions. Clawback or obligations to restore in states such as Italy last for the full lifetime of a donor and are enforceable rights \textit{in rem}, while in Germany they are monetary claims and diminish by 10 per cent per annum and disappear after 10 years. Sweden and Austria have models of administration, while in France and Spain assets vest directly in the family heirs who can then be personally liable for the deceased’s debts even if greater than the value of the deceased’s assets. In addition, the private international law or conflicts of law rules (PIL) also varied considerably. Some Member States used connecting factors of habitual residence, while others used those of domicile. The majority used that of nationality.

While the EU has not sought to affect Member States’ internal substantive law, it has for many years been seeking to harmonise Member States’ PIL in this area. The Succession Regulation (EU) No. 650/2012 finally entered into force and became fully effective in all Member States (other than Denmark, Ireland and the United Kingdom) (the SR Zone) on 17 August 2015. In the SR Zone, the universal connecting factor is now that of habitual residence and the SR Zone Member State of habitual residence has universal jurisdiction. \textit{Renvoi} has been abolished unless it is sending back into the SR Zone or to a third state that accepts such a \textit{renvoi}. A choice of national law (with no \textit{renvoi}) is also permitted and a choice made prior to 2015 is still effective. Wills and succession agreements are now accepted throughout the SR Zone. The Succession Regulation also created the European certificate of succession (ECS) for use throughout the SR Zone. Recognition of the ECS, decisions of the Member State with jurisdiction and of clawback or obligations to restore throughout the SR Zone have changed the landscape for estate planning worldwide, not only in relation to SR


Zone nationals and residents, but also in relation to SR Zone situated assets for all individuals. The case of Winkler v Shamoon [2016] EWHC 217 (Ch) is an example in England and Wales of the effect that the Succession Regulation has had on other areas of law. For the purposes of Brussels I, ‘Succession’ has been interpreted extremely widely and included oral proprietary estoppel as a matter for the Succession Regulation and therefore outside the scope of other regulations. When the United Kingdom leaves the European Union, its relationship with the Succession Regulation will remain unchanged and it will continue to apply the Succession Regulation in accordance with its own private international law rules. The CJEU has begun to rule on various aspects of the Succession Regulation.14

Similar issues also affect matrimonial property and matrimonial property regimes. The European Union has an even more complex patchwork quilt of substantive laws than of PIL. Regimes vary from full community in the Netherlands (until it was amended on 1 January 2018 for marriages after that date), to limited community in other Member States and to marital gains in Germany. PIL is governed by the 1978 Hague Convention in France, Luxembourg and the Netherlands. In other Member States, connecting factors can vary from that of nationality or residence and changes in these during a marriage sometimes do and sometimes do not produce a change, whether retroactive or not. France and Germany have agreed a new form of matrimonial regime that can be used in both countries. Again, the European Union did not propose to amend Member States’ substantive law but wished to legislate in order to harmonise Member States’ PIL. Rome IVa deals with the property effects of marriage and Rome IVb with the property regimes for registered partnerships. Owing to the significant differences in the recognition of same-sex relationships throughout the European Union, there was strong political opposition. The Visegrád Four of Hungary, Poland, Slovakia and the Czech Republic have become increasingly more vocal and some of its members vetoed (as a family matter it required unanimous support) both Rome IVa and Rome IVb. In record time, the European Union put in their place both of the Regulations under the enhanced co-operation mechanism so that they have been adopted by all EU Member States (other than Croatia, Cyprus, Denmark, Hungary, Ireland, Latvia, Lithuania, Poland, Slovakia and the United Kingdom) and will be fully effective from 2019. Rome IVa deals with the property rights of all married couples, whether opposite-sex or same-sex and similarly Rome IVb deals with the property effects of all registered partnerships, whether opposite-sex or same-sex.

Although many practitioners consider that the issues involved in matrimonial property regimes do not concern them if the domestic law of their particular state does not use the concept, the England and Wales case of Slutsker v Haron Investments Ltd15 is an example of PIL bringing such matters into play. They will continue to be of vital importance for international couples.

While the International Commission on Civil Status16 (ICCS/CIEC) has made proposals for a convention dealing with the recognition of registered partnerships, this has met with little support in the EU and the future of the ICCS seems less assured. The diversity of arrangements for the registration of marriage for same-sex couples, and for registered partnerships for same-sex and opposite-sex couples and for the recognition of such marriages and registered partnerships, cause considerable conflict.

14 For example in Kubicka C-218/16, Mahnkopf C-558/16 and the case of Oberle C-20/17.

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In many Member States, such as Belgium, France, the Netherlands, Portugal, Spain and Sweden, marriage is available to both opposite-sex and same-sex couples. The Marriage (Same Sex Couples) Act 2013 in England and Wales and the Marriage and Civil Partnership (Scotland) Act 2014 in Scotland recognised same-sex marriage from 2014. Ireland is also to introduce such legislation. The ability to convert a registered partnership to a marriage does create its own PIL problems. There appears to be no indication of any change in the law in Northern Ireland. In many states, one party must be a national or habitually resident in the particular Member State to register a marriage. In other Member States, such as Romania, Latvia and Lithuania, there are protection of marriage laws that make it unlawful for marriage to be other than between a man and a woman. In yet others, such as Austria, the Czech Republic, Finland, Germany, Hungary, Ireland, Italy, Northern Ireland and Slovenia, registered partnerships are permitted. The Netherlands permits both marriages and registered partnerships for either same-sex or opposite-sex couples. The French PACS is a form of registered contract that is available to both same-sex and opposite-sex couples. The changes to the law in Scotland and in England and Wales do not permit opposite-sex registered partnerships. Thus, while Northern Ireland will recognise a same-sex marriage from another jurisdiction as a registered partnership, and Scotland and England and Wales as a marriage, the United Kingdom will not recognise an opposite-sex Dutch-registered partnership or French PACS as either a marriage or a civil partnership. Whether a Scottish, English or Welsh same-sex marriage between a couple where one of whom is domiciled in a state that does not recognise same-sex marriage would be valid in the United Kingdom is uncertain. Adoption and recognition of surrogacy for same-sex couples is not available or recognised in many Member States.

It may be another generation before Member States’ substantive laws begin to converge sufficiently to permit some measure of harmonisation. However, Italy has now introduced the concept of a registered partnership. The CJEU decision in Coman,17 which required Romania to accept the rights of a same-sex spouse of a Romanian citizen to live in Romania, even though the marriage was not accepted in Romania, may have far-reaching effects. The impact of the United States’ Supreme Court decision in Obergefell v. Hodges18 of 26 June 2015, which required the acceptance of same-sex marriage in the United States, continues to reverberate in the United States and around the world.

VI MENTAL IMPAIRMENT

As populations live longer, the problems for individuals with diminished mental capacity across borders are also growing. The Hague Convention 35 of 13 January 2000 on the International Protection of Adults (Hague 35) deals with the PIL issues of the recognition and enforcement and the applicable law of protective measures and the applicable law for private mandates. Hague 35 has already been ratified by Austria, the Czech Republic, Estonia, Finland, France, Germany, Monaco, Portugal, Scotland and Switzerland. Cyprus, Greece, Ireland, Italy, Latvia, Luxembourg, the Netherlands and Poland have all signed but not yet ratified. It is anticipated that Latvia may ratify during 2017 and Ireland in 2018. Belgium

17 C-673/16.
is also likely to accede shortly and Spain, Sweden and Italy are also now working towards ratification. Northern Ireland may also do so, using a similar model to Schedule 3 of MCA 2005 in Schedule 9 to the Mental Capacity Act (Northern Ireland) 2016. The changes to the internal law in Ireland and Northern Ireland will be significant and Scotland is undertaking a further review.

For England and Wales there is considerable confusion since the Mental Capacity Act 2005 came fully into force on 1 October 2007 and gives full effect to the Convention notwithstanding the fact that England and Wales has not yet ratified.

The EU Parliament passed a further Resolution 2015/20185(INL) on 1 June 2017 and this issue is likely to be on the EU programme during the next five years. Member States will be encouraged to ratify and further EU legislation is possible. Hague 35 is, however, not without its own problems and further developments are likely. The inherent conflicts in the UN Convention on the Rights of Persons with Disabilities (UN CRPD) between the protection of rights under Article 12 and the protection from abuse under Article 16 are probably impossible to square. It is argued that Hague 35 and the legislation of many states bound by UN CRPD are not compatible with it. The debate is one that will continue.

VII WEALTH STRUCTURING AND REGULATION

As a result of the lack of EU competence in the area of personal taxation, there are no vehicles to provide structures that are comprehended throughout the EU. Trusts, while recognised in Cyprus, Ireland, Italy (now increasingly less novel), Malta and the United Kingdom, are not recognised in many other Member States for law purposes. The changes to French tax law in 2011 and the EU Anti-Money Laundering Directives have shown a partial acceptance of trusts and other structures for tax purposes, but even so they have not been welcomed. Belgium and Spain have followed France with similar moves. In many Member States, life insurance is given beneficial tax status, while structures such as usufructs or partnerships are also often used.

As mentioned above, Article 31 of the Fourth Anti-Money Laundering Directive, as amended by the Fifth Anti-Money Laundering Directive imposes compliance obligations on trustees of express trusts and other types of legal arrangements. Notwithstanding that access can be limited to those with legitimate interests, pressure for public registers will continue, although now subject to the countervailing pressures of the General Data Protection Regulation (GDPR) 2016/679. While seen as problematic, logically, public registers should lead to further acceptance and enforcement of trusts in the long term.

VIII OUTLOOK AND CONCLUSIONS

Harmonisation of PIL in the European Union is likely to continue. Free movement of EU nationals, goods, services and capital, although with some restraints, is still seen as an engine for growth, even though the European Union is under pressure to legislate less. The role of the CJEU will also continue to increase, although in response to political trends, it may tend towards protecting national sovereignty against EU encroachment.

All Member States were focused on debt reduction and maximising tax collection. The EU institutions are conscious of the overwhelming priority to maintain the euro as a single currency and to concentrate on economic growth. As a result, the EU institutions are likely to be proactive in encouraging any OECD and FATF initiatives that might be perceived to increase revenue share. The eurozone perspective and priorities are likely to drive those Member States in the eurozone towards ever closer union. Some Member States still consider Anglo-Saxon light-touch regulation as principally to blame for the economic and banking crises developing particularly since 2008. Pressure for increased regulation is likely to continue.

Whether the process of the UK negotiating its exit from the EU will encourage some Member States to review the previous direction of travel for the EU and whether some Member States may themselves be encouraged to become more detached is not yet clear. It is perhaps more likely that the EU will become more homogeneous, focused on civil law and perhaps more protectionist, but the tensions between those Member States inside and outside the eurozone may well deepen.
Chapter 2

THE FOREIGN ACCOUNT TAX COMPLIANCE ACT

Toni Ann Kruse and Michael D Shapiro

The Foreign Account Tax Compliance Act (FATCA), contained in Sections 1471 to 1474 of the US Internal Revenue Code (the Code), was enacted as part of the Hiring Incentives to Restore Employment Act in 2010. Final regulations under FATCA were adopted by the US Treasury on 17 January 2013, effective as of 28 January 2013, and additional regulations were adopted on 6 March 2014 and 6 January 2017 (the Regulations). On 12 July 2013, the Treasury postponed the effective date of FATCA’s withholding provisions by six months, from 1 January 2014 to 1 July 2014, as it continued to work with foreign governments in an effort to meet their requests for changes in the implementation rules.\(^2\) Withholding provisions became effective as planned on 1 July 2014. Reporting by certain financial institutions began on 31 March 2015 for the 2014 year.

FATCA was adopted with the principal purpose of preventing US persons from using foreign accounts and foreign entities to evade US tax on their assets deposited abroad. FATCA requires US payers, including US banks, brokers and companies, to withhold 30 per cent of certain ‘withholdable’ payments made to a foreign entity unless the entity qualifies for an exemption or is itself compliant with FATCA. The 30 per cent withholding rate is that which historically has been imposed on payments of interest, dividends, and other passive income by US payors to foreign persons, but until FATCA there were no withholding requirements on payments to foreign accounts of US persons. Payments made to foreign banks, brokers, investment advisers and other foreign financial institutions (FFIs) will have withholding imposed upon the full payments made to the FFI, even if most of the payment is allocable to foreign account holders, unless the FFI itself is exempt from withholding or, if not exempt, enters into an agreement with the Internal Revenue Service (IRS) to report on all US account holders. Payments made to non-financial foreign entities (NFFEs) with US owners also are subject to FATCA, with different reporting requirements than those imposed on FFIs. Essentially, FFIs report directly to the United States Treasury or to their own government, while NFFEs report to financial institutions. This chapter provides a general overview of FATCA as it relates to individuals and related entities (i.e., foreign trusts and foreign corporations owned by foreign trusts) that are deemed to be FFIs.

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1 Toni Ann Kruse is a partner and Michael D Shapiro is an associate at McDermott Will & Emery LLP. They acknowledge with great appreciation the contributions of their former partner, Henry Christensen III.
I OVERVIEW

Withholdable payments for purposes of FATCA generally include (1) payments of US-sourced ‘fixed or determinable annual or periodic’ income, such as dividends and interest; (2) payments of the gross proceeds from a sale or disposition of property occurring after 31 December 2018 that can generate US-sourced interest or dividends; and (3) ‘foreign passthru payments’ made by certain FFIs. The withholding under FATCA can be draconian; in some cases, a foreign entity may not be entitled to a refund or credit of taxes withheld in excess of the entity’s actual liability for the tax. In order to avoid this, clients must take steps to qualify for an exemption or otherwise comply with the reporting requirements.

The requirements with which a foreign entity must comply to avoid FATCA withholding differ depending on whether the entity is classified for FATCA purposes as an FFI or an NFFE, and whether the entity is resident in or organised under the laws of a jurisdiction with which the United States has entered into an intergovernmental agreement (IGA). FFIs are generally subject to a higher compliance burden than NFFEs, and compliance obligations under the Regulations may be different from those under an IGA.

Under the Regulations, an FFI is any ‘financial institution’ that is a foreign entity. There are five types of ‘financial institutions,’ but the most relevant to this chapter is an ‘investment entity’. An investment entity includes an entity the gross income of which is primarily attributable to: investing, reinvesting or trading in financial assets, and is managed by another entity that primarily conducts, as a business, on behalf of customers, the activities of individual or collective portfolio management; or investing, administering, or managing funds, money or financial assets on behalf of other persons. Generally, foreign trusts will be treated as FFIs.

The United States is offering foreign jurisdictions the opportunity to enter into one of two types of IGA that alter the compliance burdens under FATCA. In general, if the United States enters into an IGA with another country, the United States undertakes to give that country full financial disclosure concerning US accounts maintained by residents of that country in the United States, and, in certain cases, reciprocity for the financial institutions in that country giving financial disclosure to the United States Treasury on accounts maintained there by US account holders. The countries that enter into Model 1 IGAs (the Model 1 Countries) undertake to the United States to adopt internal reporting rules that replicate FATCA, and to require FFIs in the jurisdiction to report information on US accounts

3 Treas. Reg. Section 1.1473-1. The Regulations do not define ‘foreign passthru payments’; further guidance will likely define the term to include foreign-sourced payments that are treated as derived from payments described in clauses (1) and (2) above. Deductions and withholding on foreign passthru payments made by a participating FFI to an account held by a recalcitrant account holder or to a nonparticipating FFI will not begin before the later of the publication in the Regulations of a definition of ‘foreign passthru payments’ and 1 January 2019. Treas. Reg. Section 1.1471-4(b)(4).
4 Treas. Reg. Section 1.1471-5(d).
5 See Treas. Reg. Section 1.1471-5(e).
and account holders to the tax authorities of the partner jurisdiction, which then agrees to automatically share all of the reported data with the United States Treasury on an annual basis. FFIs located in or organised under the laws of a jurisdiction that has adopted a Model 1 IGA are subject to the provisions of the IGA, rather than to the Regulations. The countries that enter into Model 2 IGAs (the Model 2 Countries) agree to amend their laws in order to require FFIs in their jurisdiction to report directly to the United States Treasury information on accounts maintained by US persons within the jurisdiction.

To avoid FATCA withholding on all payments of income made to it by US payers on all accounts it maintains, an FFI generally needs to be treated as a participating FFI (PFFI) or a ‘deemed-compliant FFI’ under the Regulations. There are a number of options available to FFIs to qualify for either type of category:

a if subject to the Regulations or a Model 2 IGA, they can enter into an agreement with the IRS regarding reporting and withholding (known as an FFI Agreement) so as to qualify as a PFFI or, if subject to a Model 1 IGA, they can comply with local law so as to qualify as a ‘reporting Model 1 FFI’ (treated as a registered deemed-compliant FFI (RDC FFI) under the Regulations);

b if subject to the Regulations or a Model 1 IGA, they can fulfil the requirements to be an ‘owner documented’ FFI and thus qualify as a deemed-compliant FFI under the Regulations;

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8 See Treas. Reg. Sections 1.1471-2(a)(1), 1.1471-2(a)(4). ‘Deemed-compliant FFIs’ include RDC FFIs, CDC FFIs, non-reporting IGA FFIs, and owner-documented FFIs. FFIs that satisfy the requirements for one of these categories are considered ‘deemed compliant’ because they comply with FATCA without entering into an FFI agreement with the IRS. The overarching difference between RDC FFIs and CDC FFIs is that RDC FFIs must register with the IRS, whereas CDC FFIs need only certify their FATCA compliance to each withholding agent. See Treas. Reg. Sections 1.1471-5(f)(1), 1.1471-5(f)(1)(ii)(A), 1.1471-5(f)(2).

There has been some question as to whether foreign grantor trusts that are FFIs need to become PFFIs or deemed-compliant FFIs, or whether the payer can look through the grantor trust to its owner. Under Treas. Reg. Section 1.1471-3(a)(3)(ii)(B), it appears that a grantor trust (as a ‘flow-through entity’) that does not become a PFFI or deemed-compliant FFI will be treated as a ‘payee’ by withholding agents and will thus be subject to withholding under FATCA. More clarity on this subject has been requested from Treasury by practitioners.


10 See Treas. Reg. Sections 1.1471-1(b)(111), 1.1471-1(b)(114). If an FFI is a member of an affiliated group of entities (such as a chain or corporations and trusts connected through greater than 50 per cent ownership), the FFI generally cannot qualify as a PFFI or RDC FFI unless each other FFI in the group is a PFFI or RDC FFI. See also Treas. Reg. Sections 1.1471-1(b)(92), 1.1471-4(c)(1). There are limited exceptions to this rule; however, many of these exceptions became unavailable after 31 December 2016. See Treas. Reg. Sections 1.1471-4(e)(2), 1.1471-4(e)(3). On the other hand, if a member of an affiliated group is a holding company, it may be excluded entirely from the definition of an FFI and therefore may not need to comply with the requirements described herein to avoid FATCA withholding. See Treas. Reg. Section 1.1471-5(e)(5)(iv).

For a holding company to be so excluded, it generally cannot maintain any financial accounts or receive payments from a withholding agent other than a member of its affiliated group. The IRS FATCA registration form (Form 8957) seems to contemplate that an affiliated group of FFIs will designate a ‘lead’ entity and that the registration of all entities in the affiliated group will be linked through this lead.

they can enter into an agreement with a ‘sponsoring entity’ for the latter to comply on behalf of the FFI and other FFIs (for example, for all of a family’s foreign trusts) and thus qualify either as an RDC FFI or a certified deemed-compliant FFI (CDC FFI) under the Regulations.12

II TRUSTS AS FOREIGN FINANCIAL INSTITUTIONS AND TRUST BENEFICIARIES AS US REPORTABLE ACCOUNT HOLDERS

A foreign trust with an individual trustee should be treated as an NFFE, not an FFI. Under the Code,13 a ‘foreign financial institution’ is a foreign entity that: (1) accepts deposits in the ordinary course of a banking or similar business; (2) as a substantial portion of its business, holds financial assets for the account of others (that is, acts as a custodian); or (3) is engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest in the same. An individual trustee is not an ‘entity’; no individual trustee would meet the definitions of (1) or (2), and, as to (3), trustees are investing their own money, not that of others.14 Most large foreign trusts, however, will be treated as FFIs under the Regulations, because all foreign trusts with corporate trustees acting for different customers will be FFIs,15 as will individual trustees or private trust companies (PTCs) that retain any outside investment advisers.16 Foreign trusts may be better advised to treat themselves as FFIs, and do their own reporting, rather than as NFFEs (see discussion of alternative reporting methods below), where the depository financial institutions will determine the scope of reporting. The Regulations are not clear as to their treatment of PTCs that do all their own investing and retain no professional advisers, but such PTCs may be rare.

To be compliant with FATCA, a foreign trust that is treated as an FFI must undertake to perform due diligence so as to obtain all requisite information on its ‘account holders’ (beneficiaries), including ‘Chapter 4 status’ of the account holder (that is, whether the account holder is a US or non-US person for tax purposes), name, address, taxpayer identification number, account balance, and distributions made to any US person during the preceding tax year. Under the Regulations, a person is deemed to hold an interest in a foreign trust if he or she has mandatory or discretionary interest in the trust.17 Guidance notes and draft guidance notes in some partner jurisdictions provide clarification on whether a trust beneficiary is a US reportable account holder.

Under the FATCA Regulations, a US discretionary beneficiary of a US trust that is a financial institution is only a reportable account holder in the trust if the beneficiary actually receives distributions in a given year (referred to in the Regulations as holding an ‘equity interest’).18 FFIs subject to IGAs, however, may be subject not to compliance methods as stated in US Treasury Regulations, but rather to those stated in the relevant IGA. In the Cayman Islands, guidance notes released in December 2014 and last updated on 1 July 2015

12 Treas. Reg. Sections 1.1471-2(a)(4)(iv), 1.1471-3(d)(4), (5). This option is available to an FFI subject to the Regulations or an IGA.
13 Code Sections 1471(d)(4)-(5).
14 See also Treas. Reg. Section 1.1471-5(e)(4)(v), Example 5.
The Foreign Account Tax Compliance Act

state that the definition of ‘equity interest’ used in the Treasury Regulations may also be used under the Cayman–US IGA.19 The British Virgin Islands released guidance notes in March 2015 with a similar distribution requirement for an ‘equity interest’.20 Guernsey’s draft guidance notes21 use the same definition, as do Jersey’s,22 the Isle of Man’s,23 Ireland’s24 and Singapore’s.25 South Africa’s guidance notes take a broader approach, noting in the definition of ‘equity interest’ that a specified US person will only be treated as a beneficiary of a foreign trust if the person has the right to receive, directly or indirectly, a mandatory distribution, or may receive, directly or indirectly, a discretionary distribution.26 Mauritius’s27 and India’s28 guidance notes use the same definition as South Africa’s. It is important that each trust and financial institution determines which IGA controls it, and what definitions apply under that IGA.

III PARTICIPATING FOREIGN FINANCIAL INSTITUTIONS AND REPORTING MODEL 1 FOREIGN FINANCIAL INSTITUTIONS

Generally, FFIs that choose to comply with FATCA as a PFFI (if covered by the Regulations because the country in which the FFI is located has a Type 2 IGA with the United States or has no IGA) or a reporting Model 1 FFI (if covered by a Model 1 IGA) should register their status as such with the IRS.29 An FFI may register with the IRS through the FATCA

28 Gov’t of India Ministry of Fin. Dep’t of Rev., ‘Guidance Note on FATCA and CRS’, released May 2016, Paragraph 3.5.1.
29 See the preamble to the Regulations. Although it is not entirely clear whether a reporting Model 1 FFI is required to register with the IRS to comply with FATCA, we advise such FFIs to register in order to obtain a global intermediary identification number (a GIIN) and to safely avoid being the subject of certain due diligence and reporting requirements and being subject to FATCA withholding. See Treas. Reg. Sections 1.1471-2(a)(4)(iv), 1.1471-3(d)(4)(i); Model 1 IGA, Annex 1, Paragraph IV(D)(2)(b), V(B)(1). Form
registration portal, a secure website. In addition to registering, this portal allows an FFI to manage its registration information and, as necessary, agree to perform the due diligence, reporting and withholding requirements described herein (in other words, enter into an FFI Agreement). Upon registering, the FFI will receive a global intermediary identification number (GIIN), which it will provide to withholding agents to identify itself as a PFFI (or reporting Model 1 FFI) and avoid FATCA withholding. In our view, all foreign trusts will want to have or report under a GIIN.

To be treated as a PFFI, an FFI covered by the Regulations will be required to enter into an FFI Agreement pursuant to which it must agree to take steps to identify its ‘US accounts’, report certain information to the IRS with respect to its US accounts and withhold 30 per cent of certain payments made to individuals or entities that fail to comply with FATCA (‘recalcitrant account holders’).

Under its FFI Agreement, an FFI will be required to obtain information necessary to identify its ‘US accounts’. A US account is a financial account maintained by an FFI that is held by one or more specified US persons or US-owned foreign entities. An equity interest in an FFI is generally treated as a financial account maintained by that FFI. The PFFI will then make annual reports to Treasury on amounts distributed to US account holders.

Under the Regulations, a PFFI must deduct and withhold 30 per cent from certain payments it makes to a ‘non-participating FFI’ or to a ‘recalcitrant account holder’.

8957, which may be used by an FFI to register with the IRS, also suggests that a Model 1 FFI should register. Additionally, the IRS FATCA Online Registration User Guide states that ‘FFIs that are treated as reporting FFIs under a Model 1 IGA . . . should register as RDCFFIs’. Publication 5118 (Rev. 06-2017), Section 2.4: Special Rules for Registration, available at http://www.irs.gov/pub/irs-pdf/p5118.pdf.

See https://www.irs.gov/businesses/corporations/fatca-foreign-financial-institution-registration-system. See also IRS, Publication 5118 (Rev. 06-2017), ‘FATCA Online Registration User Guide’. The FFI can also register by filing Form 8957, which was revised in June 2017.

A reporting Model 1 FFI will not enter into an FFI Agreement but will instead be required to comply with certain requirements pursuant to local law.

See Treas. Reg. Section 1.1471-1(b)(57). See footnote 29 for discussion of GIINs.

A specified US person is, generally, any US person other than a publicly traded corporation, a tax-exempt charity, the United States government or an agency thereof, or a bank.

For the definition of a US-owned foreign entity, see the discussion below.

An equity interest in an FFI that is not an ‘investment entity’, however, is treated as a financial account only in certain circumstances. See Treas. Reg. Section 1.1471-5(b)(1)(iii). An investment entity is generally in the business of investing, administering, or managing funds on behalf of others; or generates 50 per cent or more of its income from investing, reinvesting or trading its financial assets and is professionally managed. See Treas. Reg. Section 1.1471-5(e)(4)(i), (iv). Most professionally managed trusts will be investment entities.

See Code Section 1471(c); Treas. Reg. Section 1.1471-4(d)(3). A PFFI will be required to annually report to the IRS using Form 8966: FATCA Report. Generally, such report should include the name, address and tax identification number of each US account holder; the account number (if relevant); the account balance or value of the account; the payments made with respect to the account during the calendar year; and any other information required pursuant to the instructions of Form 8966.

A non-participating FFI is generally an FFI that is not a PFFI or a deemed-compliant FFI (including an RDC FFI). Treas. Reg. Section 1.1471-1(b)(82). A recalcitrant account holder is a holder of an account maintained by an FFI who is not himself or herself an FFI and who fails to comply with requests by the FFI for documentation or information the FFI is required to
The Foreign Account Tax Compliance Act

i Foreign financial institutions covered by a Model 1 IGA

An FFI resident in or organised under the laws of a Model 1 Country will generally be covered by a Model 1 IGA. Similar to the Regulations, an FFI covered by a Model 1 IGA will be subject to specific due diligence and reporting requirements based on whether it maintains accounts held directly by US persons (e.g., a foreign trust with US beneficiaries or, in the case of a grantor trust, a US deemed owner) or maintains accounts held by other foreign entities owned by US persons (e.g., a foreign holding company owned by a foreign trust with US beneficiaries or a US owner).

ii Foreign financial institutions covered by a Model 2 IGA

To be treated as a PFFI, an FFI covered by a Model 2 IGA will be required to comply with the due diligence and reporting requirements of an FFI agreement, except to the extent modified by the terms of the Model 2 IGA.

The terms of the Model 2 IGA do not modify the due diligence and reporting requirements described in the Regulations as they apply to an FFI that is a foreign trust. The trust will be required to compile and report to the IRS information about its US owner (if it is a foreign grantor trust deemed owned by a US person), and about its US beneficiaries only to the extent that the beneficiaries are entitled to mandatory distributions or actually receive discretionary distributions.

obtain pursuant to FATCA Treas. Reg. Section 1.1471-5(g)(2). Withholding on ‘pass-through payments’ (i.e., any withholdable payment or other payment to the extent attributable to a withholdable payment) will begin no earlier than 1 January 2019. Treas. Reg. Section 1.1471-4(b)(4).

Prior to 2017, a reporting Model 1 FFI was not required to report a required US taxpayer identification number (TIN) or date of birth for an account existing prior to the applicable Model 1 IGA that is a US reportable account if the US TIN was not in the reporting Model 1 FFI’s records. Certain Model 1 FFIs needed additional time to implement practices and procedures to obtain and report required US TINs for pre-existing accounts that are US reportable accounts beginning in 2017. The Treasury Department and IRS has determined that with respect to reporting on pre-existing accounts that are US reportable accounts, for calendar years 2017, 2018, and 2019, the US competent authority will not determine that there is significant non-compliance with the obligations under an applicable Model 1 IGA with respect to a reporting Model 1 FFI solely because of a failure to obtain and report each required US TIN, provided that the reporting Model 1 FFI: obtains and reports the date of birth of each account holder and controlling person whose US TIN is not reported; requests annually from each account holder any missing required US TIN; and before reporting information that relates to calendar year 2017 to the partner jurisdiction, searches electronically searchable data maintained by the reporting Model 1 FFI for any missing required US TINs. The IRS expects to provide further instructions regarding appropriate reporting for the TIN data element for pre-existing accounts that are US reportable accounts with missing required US TINs. See IRS Notice 2017-46, 2017-41 IRB.

Similar to an FFI covered by a Model 1 IGA, an FFI covered by a Model 2 IGA that is a trust is treated as complying with the terms of the IGA if the trustee of the trust is itself a PFFI under the Regulations or an FFI in compliance with the requirements of an IGA. See Model 2 IGA, Annex II, Paragraph IV(A).

The trust will also be required to obtain consent from the beneficiaries to report their information to the IRS. See Model 2 IGA, Article 2, Paragraph 1(b), (d).
IV OWNER-DOCUMENTED FOREIGN FINANCIAL INSTITUTIONS

An FFI may be able to comply with FATCA by becoming an ‘owner-documented FFI’ (ODF). An ODF does not need to register with the IRS. Rather, the burden of providing information about the US owners and beneficiaries of an ODF is shifted to institutions with which the ODF has accounts and entities in which the ODF owns interests. The ODF approach may be of limited application to foreign trusts.

i Owner-documented foreign financial institutions under the Regulations

The ODF option is available only with respect to payments an FFI receives from and accounts held with a US financial institution, a PFFI or a reporting Model 1 FFI that agrees to undertake due diligence and reporting requirements on behalf of the ODF (a designated withholding agent).

To qualify as an ODF, an FFI will be required to provide the designated withholding agent with information about its foreign and US owners, which, in the case of an FFI that is a trust, includes information about its foreign and US beneficiaries, to the extent that its beneficiaries are entitled to mandatory distributions or may receive, and actually do receive, discretionary distributions. This option may be unattractive in view of the extent of information about owners and beneficiaries that an ODF will generally be required to disclose and, perhaps more troublesome to some trustees, the information will be disclosed to institutions and other designated withholding agents, rather than to the IRS.

As an alternative to providing designated withholding agents with information about its US and foreign owners, an ODF may provide a letter (an auditor's letter) from an accounting or law firm in the United States. The auditor's letter will generally be required to certify that the firm or a representative of the firm has reviewed the ODF's documentation with respect to all of its owners or beneficiaries. In addition to the auditor's letter, the ODF must continue to provide the designated withholding agents with information regarding its US owners or beneficiaries.

ii Owner-documented foreign financial institutions under the Model IGAs

It is unclear whether FFIs covered by the Model IGAs can comply with FATCA by meeting the requirements of an ODF. While the Model IGAs make no specific provision for ODFs, they suggest that a foreign entity that meets the requirements of a deemed-compliant FFI under the Regulations will be treated as complying with FATCA notwithstanding that the entity is subject to a Model IGA rather than the Regulations.
The Foreign Account Tax Compliance Act

V   SPONSORED FOREIGN FINANCIAL INSTITUTIONS

The sponsored entity categories allow an FFI that meets certain requirements to enter into an agreement with another entity (the sponsoring entity) under which the sponsoring entity will fulfil the sponsored FFI’s due diligence, withholding and reporting obligations on its behalf. For many foreign trust groups, it may be attractive to select one sponsoring entity to report on behalf of all entities in the group.

i  Sponsored foreign financial institutions under the Regulations

The Regulations include provisions regarding sponsored FFIs within each of the broader RDC FFI and CDC FFI categories: the RDC FFI rules provide for ‘Sponsored Investment Entities’, whereas the CDC FFI rules allow for ‘Sponsored, Closely Held Investment Vehicles’. The rules regarding sponsored investment entities and sponsored, closely held investment vehicles are very similar. Only an investment entity that is not a qualified intermediary (QI), withholding partnership (WP) or withholding trust (WT) can be a sponsored entity.

The sponsoring entity must be authorised to act on behalf of the FFI to fulfil all due diligence, withholding and reporting responsibilities that the FFI would have assumed if it were a PFFI. The sponsored entity provisions under the IGAs also require that the sponsoring entity be authorised to act on behalf of the FFI to fulfil its FATCA compliance obligations. Under the Regulations, the only potential sponsoring entity for a foreign trust that is covered by the Regulations is a trustee that is a private trust company or an institutional trustee, such that a trustee of a group of related trusts could sponsor all of them.

The sponsored and sponsoring entity must have an agreement that the sponsoring entity will undertake FATCA obligations on behalf of the sponsored entity. Under the provisions for sponsored investment entities and sponsored closely held investment vehicles, the sponsoring entity must ‘agree’ to undertake these obligations. The sponsoring entity must be registered with the IRS as a sponsoring entity.

On 6 January 2017, proposed regulations were introduced that provide verification requirements for a sponsoring entity of a sponsored FFI. Under the proposed regulations, a sponsoring entity must maintain a compliance programme to oversee its compliance with respect to each sponsored FFI for purposes of satisfying the deemed compliant status requirements of Section 1.1471-5(f)(1)(i)(F) or (f)(2)(iii) or an applicable Model 2 IGA. The deemed-compliant status requirements include the assumption by the sponsoring entity to include an FFI covered by the Model 1 IGA ‘that otherwise qualifies as a deemed-compliant FFI . . . under relevant US Treasury Regulations . . .’. See identical provisions in the Model 2 IGA, Article 1, Paragraph 1(p) and Article 3, Paragraph 4.

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50  Ibid., Section 1.1471-5(f)(2)(ii).
51  Treas. Reg. Sections 1.1471-5(f)(1)(i)(F)(1), 1.1471-5(f)(2)(ii)(A). The definitions of QIs, WPs and WTs under the Regulations (see Treas. Reg. Section 1.1471-1(b)(107), (149) and (151), respectively) direct the reader to the definitions of such persons or entities as set forth in the regulations for Code Section 1441. See Treas. Reg. Sections 1.1441-1(e)(5)(ii), 1.1441-5(c)(2)(ii) and 1.1441-5(c)(5)(v). Generally, QIs, WPs and WTs are defined as such by virtue of having entered into a withholding agreement with the IRS.
of due diligence, withholding, and reporting obligations on behalf of each sponsored FFI; and compliance with the additional requirements for status as a sponsoring entity, such as registering with the IRS.55

ii Sponsored entities under the IGAs

Both the Model 1 and Model 2 IGAs create sponsored entity mechanisms very similar to those under the Regulations. Under the Model 1 IGA, a sponsoring entity reports to the FATCA partner country on behalf of the sponsored entity, rather than to the IRS. Apart from some differences in the terminology,56 the provisions under the Model 1 and 2 IGAs regarding sponsored entities are nearly identical.

Sponsored entities under the Model 1 IGA

Under the Model 1 IGA, the United States agrees to treat each ‘non-reporting [FATCA partner] financial institution as a deemed-compliant FFI or as an exempt beneficial owner’ and such entities will be exempt from withholding.57 Annex II of the Model 1 IGA includes three categories of ‘deemed-compliant FFIs’58 among the entities identified as non-reporting FATCA partner financial institutions that are of interest. First, Annex II creates an entirely new category entitled ‘Trustee-Documented Trust’,59 under which a trustee that is a FATCA-compliant entity may comply on behalf of a trust. Annex II additionally contains a ‘Sponsored Entity and Controlled Foreign Corporation’ category and a ‘Sponsored, Closely Held Investment Vehicle’ category, each of which is very similar to the parallel category in the Regulations.60

For a trust to qualify as a deemed-compliant FFI (and therefore a non-reporting financial institution) under this category, the following requirements must be met: the trust must have been established under the laws of the FATCA partner jurisdiction at issue; the trustee of the trust must be a reporting US financial institution,61 a reporting Model 1 FFI or a PFFI; and the trustee of the trust must report all information required to be reported pursuant to the IGA with respect to all US reportable accounts62 of the trust.

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55 See Prop. Treas. Reg. Section 1.1471-5.
56 Because the Model 2 IGA generally makes use of the terms used in the Regulations, and the Model 1 IGA creates many of its own terms, certain of the terms in the rules in each IGA are different, though they generally have similar meanings.
57 Model 1 IGA, Article 4, Paragraph 4.
58 Note that the Model 1 IGA does not explicitly distinguish between RDC FFIs and CDC FFIs.
59 See Model 1 IGA, Annex II, Paragraph IV(A).
60 Ibid., Paragraphs IV(B), IV(C).
61 A reporting US financial institution is: any financial institution that is resident in the United States, but excluding any branch of such financial institution that is located outside the United States; and any branch of a financial institution not resident in the United States, if such branch is located in the United States, provided that the financial institution or branch has control, receipt, or custody of income with respect to which information is required to be exchanged under subparagraph (2)(b) of Article 2 of the Model 1 IGA. See Model 1 IGA, Article 1, Paragraph 1(p).
62 A US reportable account is a financial account maintained by a reporting [FATCA partner] financial institution and held by one or more specified US persons or by a non-US entity with one or more controlling persons that is a specified US person. See Model 1 IGA, Article 1, Paragraph 1(cc).
As is the case under the Regulations, only an investment entity established in the FATCA partner jurisdiction that is not a QI, WP or WT can be a sponsored entity. The sponsored entity must:

- have an agreement with another entity that the latter will act as sponsoring entity for the sponsored entity;\(^63\)
- be authorised to act on behalf of the sponsored entity to fulfil all registration requirements;\(^65\)
- register as such pursuant to applicable registration requirements on the IRS website;\(^66\)
- agree to perform, on behalf of the sponsored entity, all due diligence, withholding, reporting and other requirements that the sponsored entity would have been required to perform if it were a reporting financial institution;\(^67\)
- identify the sponsored entity (including, in the case of a sponsored investment entity, the identifying number of the sponsored entity, obtained by following applicable registration requirements) in all reporting completed on the sponsored entity’s behalf;\(^68\)
- register the sponsored entity pursuant to applicable registration requirements, but only if the sponsoring entity identifies any US reportable accounts with respect to the sponsored entity;\(^69\) and
- be a reporting US financial institution, a reporting Model 1 FFI or a PFFI.\(^70\)

Further, the sponsored entity must not hold itself out as an investment vehicle for unrelated parties. Twenty or fewer individuals must own all of the debt and equity interests in the sponsored entity (disregarding certain interests).\(^72\)

**Sponsored entities under the Model 2 IGA**

The provisions of the Model 2 IGA regarding deemed-compliant FFIs are virtually identical to those of the Model 1 IGA, though, of course, a sponsoring entity under the Model 2 IGA would report to the IRS on behalf of a sponsored entity rather than to the Model 2 jurisdiction government. The Model 2 IGA also specifically denotes which deemed-compliant entities are considered ‘registered deemed-compliant’ and which are considered ‘certified deemed-compliant’ (sponsored investment entities are considered the former, trustee-documented trusts and sponsored, closely held investment vehicles the latter).\(^73\)

**VI ELECTING FFI V. NFFE STATUS**

A number of US tax advisers have urged foreign trusts that seem to have a choice, as many do, to elect to be treated as NFFEs, rather than FFIs. This choice may be available, for example,

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\(^63\) See Model 1 IGA, Annex II, Paragraphs IV(B)(1), IV(C)(1).

\(^64\) Ibid., Paragraphs IV(B)(1), IV(C)(2).

\(^65\) Ibid., Paragraphs IV(B)(3)(a), IV(C)(2).

\(^66\) Ibid., Paragraphs IV(B)(3)(b), IV(C)(5)(a).

\(^67\) Ibid., Paragraphs IV(B)(3)(d), IV(C)(5)(b).

\(^68\) Ibid., Paragraphs IV(B)(3)(e), IV(C)(5)(c).

\(^69\) Ibid., Paragraph IV(B)(3)(c).

\(^70\) Ibid., Paragraph IV(C)(2).

\(^71\) Ibid., Paragraph IV(C)(3).

\(^72\) Ibid., Paragraph IV(C)(4).

\(^73\) Ibid., Paragraphs IV(A), IV(B), IV(C).
to a private trust company in an offshore jurisdiction that acts as a trustee for a number of trusts for a single family, and manages all of the investments itself. Under the Regulations, it could claim status as an NFFE, not an FFI, on the basis that its investments are not professionally managed. While initially appealing, we have concluded that this position is ultimately not the most desirable, for two reasons. First, it requires taking the position that a family’s PTC is not ‘professional’ in its investment management, a position that ultimately could prove disadvantageous in other contexts. Second, because the Regulations provide that US beneficiaries of foreign trusts that are FFIs only have to be disclosed to the extent they receive distributions, we believe status as an FFI is not intrusive, versus if the foreign trust is treated as an NFFE it must disclose whatever the US financial institution making distributions requires it to disclose.

VII IMPLEMENTATION

The FATCA registration portal opened in early 2014 and FATCA withholding and account due diligence requirements began on 1 July 2014. The deadline for sponsored entities to be registered by their relevant sponsoring entities was 1 January 2017. Since 31 March 2015, FFIs in non-IGA jurisdictions and in Model 2 IGA jurisdictions have been required to report to the IRS annually, via the IRS FATCA registration website, on certain US persons or entities that hold interests in or accounts with such FFIs. This requirement began for FFIs in Model 1 IGA jurisdictions on 30 September 2015.

i Participating jurisdictions

As of April 2018, 100 jurisdictions have entered into IGAs with the United States and 13 additional jurisdictions have reached agreements but not yet signed. The following jurisdictions have signed IGAs with the United States.

Model 1 IGA

Algeria, Angola, Anguilla, Antigua and Barbuda, Australia, Azerbaijan, the Bahamas, Bahrain, Barbados, Belarus, Belgium, Brazil, British Virgin Islands, Bulgaria, Cambodia, Canada, the Cayman Islands, Colombia, Costa Rica, Croatia, Curaçao, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Estonia, Finland, France, Georgia, Germany, Gibraltar, Greece, Greenland, Grenada, Guernsey, Guyana, the Holy See, Honduras, Hungary, Iceland, India, Ireland, Isle of Man, Israel, Italy, Jamaica, Jersey, Kazakhstan, Korea, Kosovo, Kuwait, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Montenegro, Montserrat, the Netherlands, New Zealand, Norway, Panama, the Philippines, Poland, Portugal, Qatar, Romania, Saudi Arabia, Singapore, Slovakia, Slovenia, South Africa, Spain,
St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Sweden, Thailand, Trinidad and Tobago, Turkey, Turkmenistan, Turks and Caicos Islands, Ukraine, United Arab Emirates, United Kingdom, Uzbekistan and Vietnam.

**Model 2 IGA**

Armenia, Austria, Bermuda, Chile, Hong Kong, Japan, Macao, Moldova, San Marino, Switzerland and Taiwan.\(^{79}\)

Additionally, as of April 2018, the following jurisdictions have reached agreements in substance with the United States:

**Model 1 IGA**

Cape Verde, China, Dominica, Haiti, Indonesia, Malaysia, Peru, Serbia, Seychelles and Tunisia.

**Model 2 IGA**

Iraq, Nicaragua and Paraguay.

**ii Nil reporting**

Some countries require FFIs with no ‘reportable US persons’ holding accounts to register and report the mere existence of the FFI with the partner government. This practice is referred to as ‘nil reporting’. As applied to a trust, a ‘nil report’ would include nominal information such as the trust’s name. ‘Nil reporting’ is required in Guernsey,\(^{80}\) Ireland,\(^{81}\) Malaysia,\(^{82}\) Malta,\(^{83}\) Mauritius,\(^{84}\) Singapore\(^{85}\) and South Africa\(^{86}\) at this time. Nil returns are definitively

\(^{79}\) Consistent with the Taiwan Relations Act, the parties to the agreement are the American Institute in Taiwan and the Taipei Economic and Cultural Representative Office in the United States. Id.


\(^{82}\) ‘Compliance Requirements for Malaysia-US Intergovernmental Agreement on Foreign Account Tax Compliance Act (FATCA)’, draft dated 11 September 2015, Sections 8.9.2, 9.2.4, 11.1.2.

\(^{83}\) ‘Guidelines for the implementation of the FATCA Agreement and the FATCA Regulations in Malta issued in terms of Article 96(2) of the Income Tax Act (Chapter 123 of the Laws of Malta)’, revised 29 July 2014, Section 2.18. Section 3,3 of the Malta Guidelines exempt a trust that does not have a US reportable account from nil reporting.


not required in Australia, the British Virgin Islands, Canada, the Cayman Islands, France, Isle of Man, Jersey and the United Kingdom. The US requires nil reporting by direct reporting NFFEs and by sponsoring entities reporting on behalf of a sponsored direct reporting NFFE, which must file Form 8966 to declare that it has no substantial US owners for the calendar year.

### iii Reporting portals

The IRS opened the FATCA Online Registration System in 2014 and continues to update both the website and the registration process. Upon registration and receipt of a GIIN, FFIs are added to the IRS FFI list that includes all other registered financial institutions and entities. This list is available online to facilitate FATCA implementation. As reporting increases in subsequent years, FFIs and other entities will begin filing Forms 8966 through the International Data Exchange Service, a private service available through the IRS website.

For additional guidance on how to populate the electronic form, the IRS published its revised FATCA XML v2.0 User Guide in April 2017.

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90 ‘Guidance Notes on the International Tax Compliance Requirements of the Intergovernmental Agreements between the Cayman Islands and the United States of America and the United Kingdom’, revised 1 July 2015, Section 17.3.
VIII COMMON REPORTING STANDARD

The implementation of FATCA in the United States has influenced other countries to implement similar legislation in their own jurisdictions. The United Kingdom was the first country to do so, enacting legislation that aimed to obtain information from the Crown dependencies (i.e., the Isle of Man, Guernsey and Jersey) and the British overseas territories (i.e., Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Turks and Caicos Islands, and Montserrat), commonly referred to as UK FATCA.\(^{100}\) In early 2014, the Organisation for Economic Co-operation and Development (OECD) announced an information exchange policy called the ‘Standard for Automatic Exchange of Financial Account Information: Common Reporting Standard’ (CRS).\(^{101}\) The United Kingdom worked closely with the OECD in developing the CRS, which replaced UK FATCA in May 2018.\(^{102}\) The CRS is, in large part, based on FATCA, but has significant differences. It has been adopted by other nations, without the withholding tax hammer used in FATCA, as part of a worldwide effort to accomplish transparency of income earned by residents of one country in another country.\(^{103}\) This measure has been approved by the G20 and has 146 signatory jurisdictions as of November 2017 that desire to automatically exchange tax information.\(^{104}\) The information exchange began in 2017 for 49 jurisdictions and begins in 2018 for 53 jurisdictions.\(^{105}\) As of 5 April 2018, there are more than 2,700 bilateral exchange relationships established with respect to 80 jurisdictions committed to the CRS.\(^{106}\)

\(^{100}\) Joshua D Blank and Ruth Mason, Exporting FATCA, 142 Tax Notes 1245 (2014).


I INTRODUCTION

Designing a trust entails understanding a settlor’s aspirations, wishes and objectives and melding them into an organisational regime that may last many generations. The design process requires an understanding of trust law – an area of law that is continuously evolving – as well as tax law and ancillary legal matters. Those too continue to evolve. For the international private client, an array of US and non-US jurisdictions thankfully have progressive trust laws and thus provide options.

Trust design involves many facets. This chapter explores several key aspects of modern trust design. Specifically, it considers the following questions:

- What is the optimal governance structure for the trust?
- How can a family-controlled entity play a role in the governance structure?
- How can we preserve settlor intent?
- What are the appropriate dispositive terms?
- What is the appropriate duration for the trust?
- How can we mitigate litigation risks?

Each of those questions focuses on an essential part of a trust. Addressing each question involves thoughtful drafting, as well as thoughtful situs selection. A clear, well-drafted trust deed is vital to any trust. Likewise, the selection of an appropriate situs is vital to ensuring that the trust has the right legal environment in which to grow.

II TRUST GOVERNANCE MODELS

The design of a trust’s internal governance is one of the most important aspects of trust design. The governance structure determines who is responsible for each aspect of administering a trust. For trusts, there are four governance models:

- unitary trustee;
- directed trust;
- divided trust; and
- hybrid model.

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1 Todd D Mayo is a principal, general counsel and secretary of Perspecta Trust.
These models represent an evolutionary progression. This evolution began with the unitary trustee model, which was the original governance model. The directed trust subsequently emerged in an effort to improve upon the unitary trustee model. Likewise, the divided trust evolved from the directed trust, again in an effort to improve upon its predecessor. Although it can potentially be a sensible design in some cases, the hybrid model tends to be an evolutionary anomaly. This evolutionary progression has been more pronounced in the leading US jurisdictions.

i Unitary trustee

In the unitary trustee model, the trustee is vested with all of the trustee powers. The unitary trustee model is the traditional model. The trustee has the power to make distributions, the power to invest the trust property, and the power to administer the trust. In its simplest form, one trustee is vested with all of those powers. A trust, however, may have two or more cotrustees. If there is more than one trustee, the trustees share the trustee powers and collectively must decide how to exercise those powers. In some cases, a trustee may be excluded from exercising certain powers. For example, a trustee who is a beneficiary may be excluded from participating in the exercise of discretionary distribution powers.

A trustee may delegate certain powers to a co-trustee or an agent. For example, a trustee may delegate investment powers to a professional investment manager. The delegation must be prudent. The trustee must monitor the delegate, ensuring that the delegatee is acting within the scope of the delegation and ensuring that the delegatee is acting prudently. Thus, a trustee who delegates powers does not fully absolve himself or herself of liability arising from the exercise (or non-exercise) of the delegated power. To the extent that the delegation may have been imprudent or the trustee fails to monitor adequately the delegatee, the trustee is potentially liable for any harm that the delegatee causes.

Certain powers, however, are non-delegable. Notably, a trustee generally cannot delegate the power to make discretionary distributions. In some instances, a power is non-delegable, because its delegation contravenes the settlor's intent. For example, a settlor may have appointed a person as trustee based on the person's particular experience or expertise – such as in managing a business – expecting that the person would personally exercise the related powers. In such instances, the trustee cannot delegate the powers that the settlor intended the trustee to exercise personally. The trustees are always responsible for participating in the exercise of non-delegable powers.

Advantages

The principal advantage of a unitary trustee model is its simplicity. In many cases, a single trustee or a small number of cotrustees can efficiently administer a trust. As a rule, those trusts involve uncomplicated family situations and uncomplicated trust holdings. For those trusts, a more complex governance structure – in which trustee powers are assigned to two or more persons – may be unwarranted.

Disadvantages

The unitary trustee model’s simplicity is its weakness in more complex situations. The unitary trustee model tends not to be well suited for trusts involving complicated family situations or complicated trust holdings. For those trusts, the ability to divide trustee powers among two or more persons – and partially or fully insulate each of those persons from liability for another person’s misfeasance or malfeasance – can promote more efficient trust administration and
more efficacious fulfilment of the settlor’s intent. Unlike other trust governance models, the unitary trustee model does not allow the assignment of a defined set of trustee powers to a specific person.

ii Directed trusts

In a directed trust, the trustee is vested with all of the trustee powers, but, with respect to certain powers, the trustee only acts in accordance with another person’s direction. For example, a person other than the trustee may have the power to direct the investment of the trust property. The person who has the power to direct the trustee may be the settlor, a beneficiary or another person.

**Advantages**

A directed trust offers the potential benefit of assigning trust powers to two or more persons in a manner that better achieves the trust’s purposes. At least in theory, if not always in practice, a directed trust allows a settlor to assemble a team of persons who are collectively better able to achieve the trust’s purposes than a single trustee. A settlor may wish to appoint an institutional trustee to make decisions concerning discretionary distributions and handle administrative matters, such as record-keeping, reporting and tax compliance. The settlor, however, may prefer to have someone else – perhaps an investment management firm with which he or she has a long relationship – manage the trust property. A directed trust allows the settlor to create that structure for governing the trust’s internal affairs.

A directed trust avoids the limitations associated with delegation. A trustee generally cannot delegate its discretionary distribution power, because the power is generally viewed as a non-delegable trustee power. With a directed trust, a person other than the trustee can have the power to direct the trustee to make distributions. A directed trust mitigates the risks associated with delegation. If the trustee does not have any duty to monitor the powerholder, then the trustee in fact may avoid those risks altogether. A trustee can delegate only to the extent that the delegation is prudent, and the trustee has an ongoing duty to monitor the delegatee. Thus, for example, a trustee may be reluctant to delegate investment powers to a beneficiary who lacks investment management skill or experience. With a directed trust, the trustee is not selecting the person exercising a specific power and thus is not liable for an imprudent selection. For example, the trust deed may specify that a beneficiary has the power to direct the trustee concerning the investment of the trust property.

**Disadvantages**

A directed trust poses some administrative inefficiencies, and it may not eliminate the trustee’s liability with respect to the exercise or non-exercise of powers that another person holds. With a directed trust, the trustee is in the middle of the action. A powerholder directs the trustee to take a certain action – say, make an investment – and the trustee generally must act in accordance with the direction. This two-step process – direction and action – is administratively less efficient than an arrangement in which the decision-maker is also the person taking the action. Since the trustee is in the middle of each action, the trustee remains an attractive target when something goes wrong. A disgruntled beneficiary is likely to argue that the trustee should have taken steps to prevent the alleged harm caused by the powerholder’s action or failure to act, or at least taken steps to warn the beneficiary. A
trustee, in fact, may be tempted to communicate to the powerholder its concerns about the powerholder’s actions; as illustrated by the Mennen case, succumbing to that temptation may invite questions about whether the trustee assumed certain duties to the beneficiaries.3

Some critics assert that directed trusts (and divided trusts) eviscerate the concept of a trust. By shifting the decision-making about distributions or investments from a trustee to a person who may or may not be a fiduciary or who may or may not have any liability exposure under the terms of the trust, there may be no one who can be held accountable if something goes awry. This criticism is more properly directed towards the design of specific trusts, rather than a broadside against the governance model. Directed trusts (and divided trusts) are not immune from poor design and poor implementation.

In most jurisdictions that allow them, directed trusts (and divided trusts) are largely creatures of statute, reflecting a legislative intent to shape the evolution of the concept of trusts. In those jurisdictions, the assertion that directed trusts (and divided trusts) impermissibly deviate from the fundamental concept of trusts is at best weak.

Some critics also complain that directed trusts (and divided trusts) create confusion, because two or more persons are involved in administering the trust and sometimes it can be unclear who is responsible for what. Here again, the criticism is more properly directed toward the design of specific trusts, rather than a broadside against the governance model. In some circumstances, a unitary trustee governance model is optimal. For example, the unitary trustee model is often perfectly adequate for a trust that only holds a modest portfolio of publicly traded securities. As the complexity of the trust’s objectives and the value of the trust property increases, however, a more sophisticated governance model usually is warranted.

Non-US jurisdictions

In non-US jurisdictions, the reserved powers trust is an example of a directed trust. The Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, and Jersey recognise reserved powers trusts. Under the statutes recognising reserved powers trusts, the settlor generally may reserve certain enumerated powers. In Bermuda, for example, a settlor may reserve the power to direct the distribution of trust property, the power to add or exclude beneficiaries, and the power to direct the investment of trust property.4

In some non-US jurisdictions, the statutes recognising reserved powers trusts recognise the ‘reservation’ of powers to a person other than the settlor, such as a protector or beneficiary. Bermuda is an example. In contrast, in other non-US jurisdictions, it can be unclear whether, during the settlor’s life, a person other than the settlor may have one or more of the powers and whether, upon the settlor’s incapacity or death, another person can succeed the settlor in possessing and exercising a power that the settlor had reserved to himself or herself.

Leading US jurisdictions

The leading US jurisdictions recognise directed trusts. Delaware, New Hampshire and South Dakota have comprehensive statutes governing directed trusts.5 Notably, each of those states

3 Mennen v. Wilmington Trust Co, No. 8432-ML (Del. Ch. 24 April 2015). The administrative trustee settled with the beneficiary before trial, so the court did not address whether the administrative trustee had assumed any investment-related duties.

4 Trusts (Special Provisions) Act 1989, Sections 2A(2)(c), 2A(2)(g), and 2A(2)(e).

5 Del. Code tit. 12, Section 3313; NH RSA 564-B:8-808 and NH RSA 564-B:12-1201 to NH RSA 564-B:12-1210; and SD Codified Laws Sections 55-1B-1 to 55-1B-11.
ring-fences the trustee’s and the powerholder’s respective powers and duties. In those states, a trustee does not have any duty to monitor a powerholder’s conduct, advise the powerholder, or warn a beneficiary concerning any matter in which the trustee might exercise a power in a different manner from the powerholder. To the extent that the terms of the trust provide that a trustee must follow another person’s direction, the trustee is not liable for acting in accordance with that direction. A trustee is not liable for the powerholder’s acts or omissions.

Delaware, New Hampshire, and South Dakota notably recognise trust advisers and trust protectors. A trust adviser or trust protector is a person who is not a trustee and who has one or more trust powers. In a directed trust (or a divided trust), a trust adviser or trust protector has the power to direct the trustee to take (or refrain from taking) certain actions. For example, a trust adviser may have the power to direct the trustee to make an investment, or a trust protector may have the power to veto a distribution.

Other US jurisdictions

Many other US jurisdictions recognise the power to direct, but the statutory authority fails to address many critical issues. The Uniform Trust Code, which a majority of states has adopted in some form, recognises the power to direct, unless the direction is manifestly contrary to the terms of the trust or the direction is a serious breach of a fiduciary duty that the powerholder owes to the trust’s beneficiaries.6 Thus, a trustee has a duty to monitor the powerholder’s exercise of the power to direct and make an independent assessment of whether the exercise is proper. The trustee likely also has a duty to warn the beneficiaries if it determines that the exercise or non-exercise of the power to direct may be improper or otherwise may be detrimental to their interests. For many trustees, the imposition of those ongoing duties is unattractive because the directed trust does not lessen the trustee’s potential liability.

Most US jurisdictions do not statutorily recognise trust advisers and trust protectors, and there is a dearth of common law concerning those roles. In the absence of developed law in those jurisdictions, there is considerable uncertainty concerning the nature and scope of the duties and powers that a person designated as a trust adviser or trust protector may have. Depending upon the nature and scope of the powers with which a trust adviser or trust protector is vested under the terms of a trust, a court could potentially conclude that the trust adviser or trust protector is a de facto trustee. Florida does not statutorily recognise trust advisers or trust protectors; however, in a 2015 case, a Florida appellate court recognised the role of a trust protector, concluding that the trust protector’s limited role as defined by the terms of the trust was a proper manifestation of the settlor’s intent.7 California and New York do not statutorily recognise trust advisers or trust protectors.

In 2017, the Uniform Law Commission approved the Uniform Directed Trust Act, a uniform act governing directed trusts. The Uniform Law Commission is an association of academics and practitioners who work to develop model laws that US states can adopt. In 2018, New Mexico became the first state to adopt the Uniform Directed Trust Act. As other states adopt that Act, the use of directed trusts will likely become even more widespread.

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6 Uniform Trust Code Section 808(b) (2014). In 2017, the Uniform Law Commission promulgated the Uniform Directed Trust Act, which superseded Section 808 of the Uniform Trust Code. In 2018, the Uniform Law Commission deleted Section 808 of the Uniform Trust Code. Section 808 of the Uniform Trust Code, however, remains the basis for corresponding statute in many of the states that adopted the Uniform Trust Code before 2018.

7 Minassian v. Rachins, 152 So. 3d 719 (Fla. 4th DCA 2014).
**US tax considerations**

The settlor’s retention of powers can have US income, gift and estate tax implications. The settlor’s retention of certain powers may cause the trust to be classified as a grantor trust for US income tax purposes. A grantor trust is tax-transparent. With a grantor trust, the settlor is the deemed owner of the trust property and is taxable on the income and capital gains derived from that property. The settlor’s retention of certain powers may also cause the trust property to be includible in the settlor’s gross estate for US estate tax purposes. Although there is more flexibility in designing a trust in which a beneficiary has the power to direct, potential income, gift and estate tax issues lurk there too. If a non-US person possesses a power to direct, the trust may be classified as a non-US trust for US income tax purposes. For US income tax purposes, a trust that is classified as a non-US trust is taxable only on certain US-source income. In light of the various tax issues, the settlor and his or her advisers must take care in structuring a directed trust in a manner that avoids undesirable tax consequences.

### iii Divided trusts

The divided trust is an increasingly popular governance model. The divided trust entails the division of trustee duties and powers among one or more trustees and other persons. Like a directed trust, a divided trust is a multiparty governance structure. The design of a divided trust requires consideration of the division of the powers and duties among those parties, the points at which those parties’ duties intersect and how the trust’s administration should function at those points, and the manner and extent to which the parties are insulated from the other parties’ acts and omissions.

A divided trust empowers each person who is a part of the trust’s governance to take direct action. In contrast, in a directed trust, a powerholder acts indirectly, directing the trustee to take a specific act. In a divided trust, each powerholder acts independently and acts directly. For example, in a directed trust, the settlor may have the power to direct the trustee on matters concerning the investment of the trust property. When the settlor wishes to buy an asset, the settlor must direct the trustee to buy the asset, and the trustee subsequently will take the necessary action to buy the asset. The trustee will execute the requisite documents, deliver the funds to the seller, and accept receipt of the newly acquired asset.

**Advantages**

Divided trusts share the advantages of directed trusts, but generally are more efficient to administer, because each person involved in the trust’s governance can act directly. In addition, a divided trust potentially better insulates a trustee from liability, because the trustee is not involved in another person’s exercise of a distribution power, investment power, or other trustee power.

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8 26 USC Sections 671-679.
9 26 USC Sections 2031-2046.
10 26 CFR Section 301.7701-7.
11 In practice, some people bypass the trustee of a directed trust. Under the theory that the powerholder is acting as the trustee’s agent or in some cases with less forethought, an accommodating trustee sometimes allows a powerholder to take the action directly (for example, taking the actions necessary to buy the asset). That approach is not without risk. The trustee may be breaching its fiduciary duties depending upon the terms of the trust and the applicable law.
**Disadvantages**

Divided trusts generally share the disadvantages of directed trusts, except that divided trusts generally avoid the administrative inefficiencies inherent in directed trusts. Divided trusts can be more challenging to draft than directed trusts. In a directed trust, the trustee is vested with all of the trust powers, so the trustee unilaterally can exercise any power to the extent that another person does not have the power to direct the trustee with respect to that power. In a divided trust, there is a risk that the drafting attorney will fail to assign a trust power to a person.

**Non-US jurisdictions**

Although leading US jurisdictions are the vanguard of this evolutionary development of trust law, many non-US jurisdictions have at least partially embraced the concept of divided trusts. For example, the Cayman Islands allows a settlor to grant certain powers to another person.\(^ {12} \)

Those powers may include powers to revoke the trust, vary or modify the terms of the trust, distribute trust property, and change the trust’s *situs*. The Bahamas, Bermuda, Jersey and Guernsey have enacted similar laws.\(^ {13} \)

**Leading US jurisdictions**

The leading US jurisdictions recognise divided trusts. Delaware, New Hampshire and South Dakota have comprehensive statutes governing divided trusts.\(^ {14} \) Notably, each of those states generally ring-fences the powers, duties and liabilities of the trustees, trust advisers and trust protectors.

New Hampshire’s highest court was the first US court that expressly upheld divided trusts. In the *Tamposi* case decided in 2013, the New Hampshire Supreme Court affirmed the division of investment and distribution powers between two classes of trustee, which, under the terms of the trust, were called ‘investment directors’ and ‘trustees’.\(^ {15} \) Under the terms of the trust, the trustee had the power to make distributions, and the investment directors had the exclusive power to invest and manage the trust property. One of the settlor’s daughters sued both the trustee and investment directors for breach of trust, alleging in part that the investment directors had improperly managed the trust property. In construing the terms of the trust, the court concluded that the trustee did not have any duty with respect to investment matters, because the investment directors were exclusively vested with the investment powers. The court similarly concluded that the investment directors did not have any duties with respect to distributions, because the trustee was exclusively vested with the discretionary distribution powers.

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12 Cayman Islands Trust Laws (2011 Revision), Section 14.
13 Bahamas Trustee Act 1988, Section 3; Bermuda Trusts (Special Provisions) Act 1989, Section 2A; Jersey Trusts Law 1984, Article 9A; Guernsey Trusts Law 2007, Section 15.
14 Del. Code tit. 12, Section 3313; NH RSA 564-B:8-808 and NH RSA 564-B:12-1201 to NH RSA 564-B:12-1210; and SD Codified Laws Sections 55-1B-1 to 55-1B-11.
Other US jurisdictions
Nevada, Tennessee and Wyoming recognise divided trusts. In many other US jurisdictions, the statutes do not provide clear authority for divided trusts. California, Florida and New York are among the states that lack clear authority for divided trusts.

In 2017, the Uniform Law Commission approved the Uniform Directed Trust Act, a model act governing directed and divided trusts. In 2018, New Mexico adopted the Act. Other US jurisdictions will likely follow. Accordingly, the use of divided trusts will likely become more commonplace throughout the US.

US tax considerations
The division of trust powers can affect the trust’s status for US income tax purposes, and it can affect whether the person vested with certain powers may be subject to US income, gift and estate taxes. Accordingly, the settlor and his or her advisers must take care in structuring a divided trust in a manner that avoids undesirable tax consequences.

iv Hybrid governance model
A hybrid governance model incorporates elements of a directed trust and a divided trust. For example, a trust instrument may grant to a person the power to direct the trustee to make distributions, while granting to another person the exclusive power to manage the trust property. Too often, a hybrid governance model arises by accident, as the product of inartful drafting. A drafting attorney may attempt to create a divided trust using a trust deed for a directed trust as a precedent but fail to address fully the division of the trust powers.

III USE OF FAMILY-CONTROLLED ENTITIES IN TRUST GOVERNANCE
Some families seek to include family-controlled entities in the governance structure of the family’s trusts. Those entities include a family-controlled holding company under a trust, non-bank trust advisers and trust protectors, and private trust companies.

i Holding companies
In both US and non-US jurisdictions, a common technique for enabling the settlor or other family members to control investments is the use of a holding company. The trust generally holds an operating cash account and the interest in the holding company. The trustee uses the operating cash account to pay trust expenses and make distributions. The holding company holds the investments, either directly or indirectly through one or more subsidiary companies. The settlor or one or more family members serve as the directors or managers of the holdings company and any subsidiary companies. In their capacity as directors or managers, the settlor and the family members control the investments.

The use of a holding company minimises the trustee’s involvement in any investment activity, because the investment activity is occurring one or more levels below the trust. At the trust level, a key consideration is the waiver of the duty to diversify, so that holding an undiversified portfolio (an operating cash account and an interest in a holding company that may or may not hold a diversified portfolio) is not a breach of any fiduciary duties. In the case of a directed trust or divided trust, a person other than the trustee may be vested with the investment powers and thus would make any determination whether to retain the interest in the holding company.
ii Non-bank advisers and protectors

New Hampshire and South Dakota expressly allow a non-bank company to act as a trust adviser or trust protector (i.e., possess certain trust powers).\textsuperscript{16} Those states have statutory safe harbours that, subject to certain conditions, permit a company to act as a trust adviser or trust protector without obtaining a charter as a bank or trust company. Coupled with a divided trust, a non-bank trust adviser or trust protector enables a family to create a structure that generally emulates a private trust company, while avoiding the regulatory and compliance issues involved in forming and operating a private trust company.

New Hampshire has two safe harbours. The newer safe harbour, which was enacted in 2017, generally allows a corporation, limited liability company, or foundation to act as a trust adviser or trust protector, so long as the company does not provide services to the general public. This safe harbour also allows a company to act as a private trust company. The older safe harbour is more restrictive. The older safe harbour applies only if the company’s trust powers are limited (e.g., only discretionary distribution powers). Neither safe harbour requires the company to register with the state’s banking commission.

South Dakota’s safe harbour allows the company to have a broad array of trust powers but requires the trustee to be a South Dakota-chartered bank or trust company or US-chartered bank with trust powers. In addition, South Dakota imposes a notice filing requirement. The entity acting as a trust adviser or trust protector must register with the state’s banking commission and file an annual report with the banking commission.

Unlike New Hampshire and South Dakota, Delaware does not have a statutory safe harbour for non-bank companies that act as trust advisers or trust protectors. Nonetheless, some practitioners form Delaware companies that act in those capacities.

iii Private trust companies

A private trust company is a company that is qualified to exercise trust powers for the members of a family and their related trusts, companies and charities. A private trust company can be attractive because it enables a family to have a family-controlled institutional trustee for their trusts, develop governance and succession plans within a single entity (rather than across many trusts) and potentially develop a more professional system for administering the family’s trusts and managing its wealth.

Non-US jurisdictions

The Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey and Jersey allow private trust companies.

Leading US jurisdictions

New Hampshire and South Dakota allow the formation of private trust companies.\textsuperscript{17} New Hampshire allows the formation of licensed and unlicensed private trust companies. South Dakota allows only the formation of licensed private trust companies.

\textsuperscript{16} NH RSA 293-A:3.05 (relating to corporations), NH RSA 304-C:22-a (relating to limited liability companies), NH RSA 564-F:8-802 (relating to foundations), and NH RSA 383-C:12-1201 to NH RSA 383-C:12-1202; and SD Codified Laws Section 51A-6A-66.

\textsuperscript{17} For a general discussion of private trust companies, see Miles C Padgett, ‘Private Trust Companies: A Practical Introduction to a Bespoke Solution’, Investments & Wealth Monitor, January/February 2016, pp. 37–41.
A licensed (or regulated) private trust company is chartered and supervised by the state’s banking commission. An unlicensed (or unregulated) private trust company is not subject to the supervision of the state’s banking commission. A licensed private trust company generally is exempt from registration as an investment adviser with the US Securities and Exchange Commission (SEC). An unlicensed private trust company that provides investment advisory services generally must register as an investment adviser with the SEC, unless it qualifies for the family office exemption.\textsuperscript{18} The choice between a licensed private trust company and an unlicensed private trust company often turns on whether the family values the discipline that a state banking commission generally demands and the supervision that it imposes.

New Hampshire does not require a private trust company to maintain an office within the state or impose any residency or citizenship requirements on its directors. Although maintaining an office in the state is unnecessary under New Hampshire law, it often is advisable for purposes of mitigating the risk that the private trust company is treated as a resident in another jurisdiction under a mind and management test or another legal standard. Notably, New Hampshire also allows a private trust company formed in another jurisdiction, including a non-US jurisdiction, to operate within the state. In New Hampshire, a private trust company may be formed as a corporation, limited liability company, or foundation.\textsuperscript{19}

Like New Hampshire, South Dakota does not require a private trust company to maintain an office within the state.\textsuperscript{20} (Again, it may be advisable to do so.) Unlike New Hampshire, South Dakota requires a private trust company to have at least one resident director and requires at least one-half of its directors to be US citizens.\textsuperscript{21}

New Hampshire and South Dakota require a licensed trust company to maintain at least $200,000 of capital.

Delaware does not allow the formation of private trust companies.

Other US jurisdictions
Florida, Ohio, Nevada, Tennessee and Wyoming allow the formation of licensed private trust companies. Each of those states require a licensed private trust company to maintain a minimum amount of capital. For example, the statutory minimum capital is US$250,000 in Florida, US$300,000 in Nevada and US$500,000 in Wyoming. Florida, Ohio, Nevada and Wyoming require a licensed private trust company to maintain an office in the state. In Nevada, a licensed private trust company must have at least one resident director.

Florida, Nevada, Ohio and Wyoming allow the formation of unlicensed private trust companies. Those states generally require an unlicensed private trust company to file initial and annual notices with the state banking commission; the regulatory requirements generally are more relaxed than those applicable to licensed private trust companies. Notably, however, Florida requires an unlicensed private trust company to maintain at least US$250,000 of capital and maintain an office within the state.

California and New York do not allow the formation of private trust companies.

\textsuperscript{18} See 15 USC Section 80b-2(a)(11)(G).
\textsuperscript{19} NH RSA 293-A:3.05 (relating to corporations), NH RSA 304-C:22-a (relating to limited liability companies), NH RSA 564-F:8-802 (relating to foundations), and NH RSA 383-D:5-501A(a)(3) (governing licensed private trust companies).
\textsuperscript{20} See SD Codified Laws Sections 51A-6A-11.1, 51A-6A-12, and 51A-6A-13 (governing trust companies other than private trust companies).
\textsuperscript{21} SD Codified Laws Section 51A-6A-13.
IV SETTLOR INTENT

For some settlors, the preservation of his or her intent is critically important. Other settlors are less concerned with whether his or her specific wishes and mandates will be strictly applied to future generations, who will largely comprise individuals the settlors will have never met or known. Even for a settlor who counts himself or herself in that latter group – and in some ways more importantly, the trustees and other persons charged with administering a trust – the preservation of settlor intent is important, because it may affect the efficacy of the settlor’s modification or waiver of certain duties, such as the duty to diversify or the duty to inform.

i Non-US jurisdictions

Compared to the leading US jurisdictions, non-US jurisdictions generally are less rigorous in protecting settlor intent. For example, many non-US jurisdictions allow the beneficiaries to terminate a trust. Subject to some variation, the Saunders rule is generally applicable in non-US jurisdictions.22 Under that rule, the beneficiaries of a trust can terminate the trust by unanimous agreement. Generally, all of the beneficiaries must be adults and must be competent.

ii Leading US jurisdictions

New Hampshire and South Dakota protect settlor intent. Within the US, New Hampshire may offer the strongest protection of settlor intent. New Hampshire’s tradition of respecting settlor intent is long-standing, and it infuses the state’s statutory regime. In Burtman, the state’s highest court wrote, ‘probably no jurisdiction has stood more steadfastly for giving effect to the intention of the [settlor] rather than to arbitrary rules of law than New Hampshire’.23 In Lowy, the court stated that, ‘when we construe a trust, the intention of a settlor is paramount’.24 New Hampshire has incorporated this paradigm into its statutes. In interpreting or construing the terms of a trust, New Hampshire’s statutes provide that, ‘the settlor’s intent shall be sovereign to the extent that the settlor’s intent is lawful, not contrary to public policy, and possible to achieve’.25 Similarly, in applying and construing the New Hampshire Trust Code, New Hampshire’s statutes provide that a court must give ‘primary consideration . . . to the preservation of the settlor’s intent as expressed in the terms of the trust’.26

iii Other US jurisdictions

US jurisdictions have historically rejected the Saunders rule. Instead, US jurisdictions have generally applied the material purpose test that was articulated in Claflin.27 Under that test, the beneficiaries could not terminate a trust so long as the trust’s continuation was necessary to achieve a material purpose of the trust. More recently, many US jurisdictions have adopted

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22 Saunders v. Vautier, EWHC Ch J82 (1868).
25 NH RSA 564-B:1-112.
26 NH RSA 564-B:11-1101.
27 Claflin v. Claflin, 149 Mass. 19 (1889).
a variation of the *Saunders* rule, allowing the modification or termination of a trust even if the modification or termination would violate a material purpose of the trust. In some states, the settlor’s agreement is necessary to modify or terminate a trust in violation of a material purpose of the trust. Many US jurisdictions have also adopted (or at least have not expressly rejected) the benefit-of-the-beneficiary rule, which elevates the beneficiaries’ interests over settlor intent.28

V DISPOSITIVE TERMS

i Discretionary distributions
Discretionary distributions provide flexibility to address changing circumstances. With discretionary distributions, the trustee can make distributions – and, importantly, refrain from making distributions – as appropriate based on the beneficiaries’ circumstances at the time. So long as property remains in a (properly designed) trust and distributions are discretionary, the property is generally outside the reach of a beneficiary’s creditors and, in the case of a person subject to US estate taxes, potentially excluded from his or her gross estate for US estate tax purposes. In addition, with discretionary distributions, a trustee is able to refrain from making distributions that may support a beneficiary’s addictive behaviours (e.g., gambling or substance abuse). In the context of a divorce, for example, a beneficiary’s right to receive a mandatory income distribution may be treated as marital property and, thus, subject to division.

Mandatory income distributions also can restrain the trustee’s investment of the trust property. A fully discretionary trust enables the trustee to invest for total return. A trust that contains mandatory income distributions generally forces the trustee (or whoever has investment powers) to invest the trust property in a manner that generates reasonable income, which, especially in the current interest rate environment, may be less than the income generated by a portfolio invested for total return.

In the trust deed, the settlor ideally would include a statement of intent or some precatory clauses, so that the trustee has some guidance concerning the purposes, timing and amounts of distributions that the trustee should make. Alternately, the settlor could provide a letter of wishes, again for the purpose of guiding the trustee in its exercise of its power to make discretionary distributions.

ii Power to add beneficiaries
The power to add beneficiaries can provide additional flexibility. The use of the power is more common in trusts that have *situs* in non-US jurisdictions. The less frequent use of the power to add beneficiaries in a US-*situs* trust likely stems from the attitudes of settlors and their advisers towards control. A well-designed trust deed, however, can include effective checks and balances so that the exercise of a power to add beneficiaries does not derail the trust’s purposes while providing the additional flexibility that can help to ensure that the trust achieves the settlor’s objectives in the face of changing circumstances.

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In the US, there are potential tax implications if the trust deed includes a power to add beneficiaries. The trustee's power to add beneficiaries will cause the trust to be classified as a grantor trust for US income tax purposes (subject to additional conditions if the settlor is not a US person). Thus, the settlor would be taxable on the trust's income and gains. That result is often desirable, because it can yield more tax-efficient wealth transfer after taking into account US gift and estate taxes.

VI TRUST DURATION

In many jurisdictions, a settlor can create a perpetual or quasi-perpetual trust. The practical effect of perpetual trusts is the elimination of an arbitrary limit on the duration of trusts. Without any limit on a trust's duration, a settlor can allow the trustee to determine the proper time to terminate a trust, taking into account the beneficiaries' circumstances and the costs of administering the trust. For example, the trustee can refrain from making a terminating distribution at a time when a beneficiary is emotionally or financially immature, is suffering injurious addictive behaviours, such as gambling or substance abuse, or faces the likely loss of the distributed property to spousal claims, creditor claims or taxes. By its nature, a multigenerational trust will likely reach practical limitations on its efficient administration. As the beneficiary class expands from generation to generation, the trust may become too unwieldy to administer, or it may divide into many subtrusts that are economically inefficient to administer. In either case, the lack of any limitation on the trust's duration enables the trustee to assess the administrative costs and complexities and terminate the trust when those costs and complexities outweigh the advantages that the trust offers.

i Non-US jurisdictions

The Bahamas, Bermuda, Guernsey and Jersey allow trusts of unlimited duration. The British Virgin Islands allows a purpose trust of unlimited duration but limits the duration of a non-charitable trust to 360 years. The Cayman Islands allows a STAR trust (its form of purposes trust) of unlimited duration but limits the duration of a non-charitable trust to 150 years.

ii Leading US jurisdictions

New Hampshire and South Dakota allow trusts of unlimited duration. Delaware allows a trust of unlimited duration, except to the extent that the trust directly holds real property. Delaware limits the duration of a trust that directly holds real property to 110 years. Through proper planning, Delaware's durational limitation on trusts holding real property is avoidable. The limitation does not apply to a trust to the extent that the trust indirectly holds real property, such as through a limited liability company or partnership.

iii Other US jurisdictions

Nevada limits the duration of trusts to 365 years, Tennessee limits their duration to 360 years and Wyoming limits their duration to 1,000 years. A recent scholarly article, however,
questions the validity of those states’ statutes allowing for quasi-perpetual trusts.30 In each of those states, the state constitution expressly prohibits perpetuities. The article’s authors assert that the statutes purportedly allowing quasi-perpetual trusts violate those constitutional prohibitions, because the statutes deviate too substantially from the traditional limits on the deferred vesting of property interests. If their analysis is correct, trusts created under those statutes may be limited in duration by the rule against perpetuities or may possibly be invalid.

In Bullion Monarch Mining Inc, Nevada’s highest court held that the rule against perpetuities does not apply to a royalty provision in a commercial contract.31 In the opinion, the court mentions the 365-year period applicable to trusts, and it recognised the legislature’s role in articulating current public policy. The ruling may give some people comfort. The court, however, did not expressly address whether, as it applies to trusts, the statutory 365-year rule is valid under the state’s constitution.

California and Massachusetts continue to apply the rule against perpetuities but have adopted wait-and-see statutes that mitigate the rule’s harsh effects. New York applies the rule against perpetuities.

VII DISPUTE MITIGATION AND RESOLUTION

i Governance structure
The design and implementation of the governance structure plays a critical role in mitigating disputes. The trust deed should specify the qualifications of trustees, trust advisers, trust protectors and enforcers. An inexperienced trustee, trust adviser, trust protector, or enforcer can wreak havoc with a trust. A governance structure that includes appropriate checks and balances helps to keep the trustees, trust advisers, trust protectors, and enforcers attentive and, as appropriate, accountable. A trust’s governance structure should include procedures for removing and appointing trustees, trust advisers, trust protectors and enforcers. In some trusts, term limits and age limits are beneficial.

ii No-contest provisions (forfeiture provision)
A no-contest provision is a provision that terminates a beneficiary’s interest in a trust if the beneficiary contests the trust or the trustee’s actions. A no-contest provision – also called an in terrorem clause or forfeiture provision – can serve as a deterrent to litigation.

A no-contest provision changes the economic calculus. This may be especially true in the US, where, in the absence of a no-contest provision, a beneficiary’s downside cost of contesting a trust may be limited to the beneficiary’s own legal fees. In some US jurisdictions, that cost may be nearly nil, because some attorneys are willing to pursue trust contests on a contingency fee basis and financing for trust litigation is becoming more available, collecting a fee only if the attorney succeeds in obtaining some financial benefit for the beneficiary. With a no-contest provision, the beneficiary’s economic analysis changes. The beneficiary’s downside cost is the loss of his, her or its interest in the trust. Thus, a rational beneficiary must have a higher degree of confidence in his, her or its claim. Of course, not all beneficiaries

are rational, and a beneficiary who unsuccessfully challenges a trust that contains a no-contest provision and consequently loses his or her interest in the trust may turn on his or her advisers.\footnote{See, e.g., Tamposi v. Denby, 136 F. Supp. 3d 77 (D. Mass. 2015).}

**Non-US jurisdictions**

In non-US jurisdictions, the enforceability of no-contest provisions in trust deeds is based largely on common law. The common law concerning the enforceability of no-contest provisions in wills is better established and has served as a foundation for the few cases involving trusts. The Cayman court enforced a no-contest provision in a trust deed in *AN v. Barclays Private Bank & Trust (Cayman)* Ltd\footnote{*AN v. Barclays Private Bank & Trust (Cayman)* Ltd [2006] CILR 365.} and, more recently, in *AB Jnr & Another v. MB & Others*.\footnote{In the Matter of the Estate of PQR, Deceased [2014] Bda No. 205.} In a 2014 case upholding the enforceability of a no-contest provision in a will, the Bermuda court favourably cited the *AN* case. The Bahamas statutorily recognises the enforceability of a no-contest provision that applies to a beneficiary who challenges the trust’s validity.\footnote{The Bahamas Trustee Act, Section 87A.}

**Leading US jurisdictions**

Within the US, the leading trust jurisdictions enforce a no-contest provision. Delaware, New Hampshire and South Dakota statutorily enforce no-contest provisions.\footnote{Del. Code tit. 12, Section 3329; NH RSA 564-B:10-1014; and S.D. Codified Laws Section 55-1-46 to 55-1-51.} Delaware and New Hampshire enforce a no-contest provision, even if the beneficiary acts in good faith or with probable cause in contesting the trust. Although a no-contest provision, which applies even if a beneficiary acts in good faith or with probable cause, is a strong deterrent against litigation, it may not be optimal trust design because it can severely restrict an effective check on the trust officials’ conduct. In contrast to Delaware and New Hampshire, South Dakota will not enforce a no-contest provision against a beneficiary who acts in good faith or with probable cause in contesting the trust. In addition to its statutory enforcement of no-contest provisions, New Hampshire expressly authorises a trustee to suspend distributions to a beneficiary who may have violated a no-contest provision.\footnote{NH RSA 564-B:10-1014(f).}

**Other US jurisdictions**

provision and thus narrowly construe them, and a no-contest provision likely is unenforceable to the extent that the beneficiary acts with probable cause in contesting the trust. Notably, Florida does not enforce no-contest provisions. Florida views a no-contest provision as contrary to public policy, because it limits a beneficiary’s right to challenge a trustee’s actions. Florida has codified its prohibition against the enforcement of no-contest provisions.

iii Non-judicial dispute resolution

Many wealthy families value privacy. Even families whose business or philanthropic interests expose them to significant public attention often wish to preserve the privacy surrounding their wealth and the manner in which they structure the disposition of that wealth. Thus, for many wealthy families, the private resolution of any trust disputes is an important aspect of trust design. In addition to avoiding the publicity that a judicial proceeding may entail, they wish to ensure that they have greater say in the qualifications of the individuals who decide any matters affecting the family’s wealth.

Leading US jurisdictions

The leading US trust jurisdictions expressly recognize non-judicial dispute resolution provisions in trust deeds. In New Hampshire, non-judicial dispute resolution procedures are enforceable if the procedures are reasonable. Those procedures may govern any matter except the determination of a trust’s validity or the determination of a trust’s material purposes. Delaware and South Dakota also recognize non-judicial dispute resolution procedures.

Other US jurisdictions

Other US jurisdictions generally do not expressly recognize non-judicial dispute resolution provisions in trust deeds. For example, California, New York and Wyoming do not statutorily recognize non-judicial dispute resolution provisions. In contrast, Arizona and Florida do.

iv Lifetime approval of trusts

A settlor who anticipates the possibility of a dispute concerning the validity of his or her trust may value the ability to obtain a declaratory ruling affirming the trust’s validity. For the settlor as well as the court, a key benefit of the settlor seeking the determination is the settlor’s availability as a witness. In many instances, a challenge to a trust’s validity arises after the settlor’s death, at which point the best witness is unavailable. In the US, Delaware and New Hampshire statutorily allows a settlor to seek a court’s determination of a trust’s validity.

NOTES ON THE TAXATION OF WORKS OF ART IN THE UNITED KINGDOM

Ruth Cornett

I INTRODUCTION

The ownership of works of art forms a significant part of the wealth of many international private clients, and the kudos and personal enjoyment that comes with such ownership is an added benefit to the financial returns many collectors have witnessed in recent years. In the United Kingdom, the art market services international clientele, attracting dealers and collectors from around the globe. A significant boom took place between 2010 and 2015, which was followed by a market correction in 2016; however, during 2017 and continuing into 2018 there has been a recovery in the market and confidence in art as an asset class has returned. Many collectors who may have initially acquired works of art purely for pleasure have since witnessed their acquisitions become a significant proportion of their net wealth during the last decade and, with this in mind, other collectors have entered the market seeking to spread their class of investments. Whether this will continue cannot be certain, but for the moment, the fiscal policy has remained largely unchanged. Since the result of the June 2016 UK referendum on membership of the European Union, there has been speculation about the impact Brexit will have on the art market, but no changes to the current rules or policies have been announced at the time of writing.

UK government policy is generally in favour of arts and heritage. The importance of the art, culture and heritage industries for the UK economy is widely promoted and has been recognised in some favourable tax treatments (see below). Nevertheless, the importance of

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1 Ruth Cornett is the director of the Heritage and Taxation Advisory Service at Christie’s.
3 See, for example, the reported drop in the sale results of both Sotheby’s and Christie’s in the first half of 2016, with results dropping by approximately 27 per cent.
4 Christie’s auction sales results for the first half of 2017 showed a 29 per cent increase over the same period in 2016, with sales overall of £2.35 billion. In November 2017, Christie’s sold Leonardo da Vinci’s Salvator Mundi for US$453.3 million, the highest price ever achieved for a single work of art at auction. The sales of the collection owned by Peggy and David Rockefeller at Christie’s in spring 2018 generated proceeds of US$832.6 million. Christie’s results for the first half of 2018 showed a rise of 26 per cent over the same period in 2017 and the highest level in the company’s history.
5 The post-war and contemporary art market rose overall by 87 per cent in the decade from September 2008 to June 2018. Source: Art Market Research index data results.
6 See, for example, the policy document ‘Heritage Means Business’ launched by the UK Historic Houses Association (HHA) in March 2014 and the HHA’s own survey of members in 2015. The HHA’s 2015 survey estimated that visits to historic houses and gardens in private ownership exceeded 24 million per annum.
establishing the correct ownership structure must be the first consideration for collectors and it is useful to bear in mind the ultimate destination for any collection when deciding how it should be owned, whether that is a legacy to the next generation, a bequest to a museum or, in due course, a sale.

The United Kingdom does not maintain a general register of chattels, although the UK’s tax collecting and administration agency, Her Majesty’s Revenue and Customs (HMRC), does keep a register of works of art that are conditionally exempt from inheritance tax (IHT). Currently, there is no wealth tax applicable to individuals or their chattels, and consequently there are attractions in terms of privacy, personal enjoyment and deferred taxation to this class of investments for those who are willing to hold non-income producing assets as part of their overall portfolio. Many works of art in the United Kingdom have been held by the same families for generations and the UK tax legislation has beneficial rules to encourage the care and maintenance of heritage chattels in private ownership\(^7\) so long as owners give public access to those objects. Since as far back as 1896\(^8\) there has been a recognition that heritage assets require special protection and successive legislation has addressed this point.\(^9\)

The government acknowledges that, in order to thrive, the art market requires participation from, and access to, buyers and sellers across the world.\(^10\) Through its export-licensing system, the government seeks to strike a balance between the protection and retention in the United Kingdom of those works of art and cultural objects that it considers are of outstanding national importance (and whose export would be a misfortune), and the needs of the UK art market. This is a particularly specialised area and separate advice should always be sought from recognised experts should an export licence for any cultural object or work of art be required.

Finally, the United Kingdom is a signatory to the Convention on the International Trade of Endangered Species and any work of art containing material from endangered species may be subject to import or export restrictions. Value added tax and excise duty are also applicable in certain circumstances, but both are outside the scope of these notes.

II RELEVANT TAX CONSIDERATIONS

The general rules for the taxation of works of art follow the United Kingdom’s tax legislation for the relevant ownership structure. Consequently, UK-resident and domiciled individuals are taxed on gains arising on disposal of chattels worldwide, at their prevailing rate of capital

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\(^7\) See, for example, the conditional exemption rules (Sections 30–35A Inheritance Tax Act 1984 and Section 258 Taxation of Chargeable Gains Act 1992).

\(^8\) Section 20 Finance Act 1896.

\(^9\) See, for example, Section 63 Finance Act 1910, Section 40 Finance Act 1930 and Section 39 Finance Act 1969.

\(^10\) The Reviewing Committee on the Export of Works of Art and Objects of Cultural Interest (RCEWA) was set up in 1952 following the Waverley Report issued in the same year. The Waverley Report was commissioned in response to the perceived loss of works of art through sales from the United Kingdom in the immediate post-war period. The most recent annual report of the RCEWA was published in April 2018 and it, together with more details about the rules for the export of works of art, can be read online at: www.artscouncil.org.uk/publication/export-objects-cultural-interest-201617.
gains tax (CGT) (usually at 20 per cent). On death, chattels are valued and IHT at 40 per cent is paid above the relevant threshold. There are some useful exemptions from both taxes (see below). Income tax is payable by self-employed art dealers and agents, and corporation tax by companies dealing in art. UK trustees holding works of art are subject to the rules applicable to trusts and, for relevant property trusts, this means that an IHT charge at around 6 per cent is applied every 10 years to the value of the chattels owned at that date. Likewise, IHT and potentially CGT charges apply on the creation of trusts and appointments from them.

i Capital gains tax

For CGT purposes, particular forms of relief apply to any gains arising on the disposal of chattels. Those chattels disposed of for proceeds (deemed or actual) of £6,000 or less are exempt from CGT, irrespective of any gain arising on that disposal, or the number of chattels disposed of and qualifying for this relief, in any year. Likewise, losses arising on a disposal for £6,000 or less are restricted. One of the advantages of the ‘chattels’ relief’ is that the taxpayer is still able to use the annual exemption for CGT purposes against any remaining chargeable gains.

In addition to the general chattels’ relief, certain types of chattels are exempt from CGT altogether; for example, no CGT is due on the disposal of private passenger vehicles, wasting assets and chattels held to be plant or machinery. In this context, machinery includes other motor vehicles not normally used as private passenger vehicles. Specific rules apply to the treatment of sets of chattels, a good example of which would be the sale of a set of dining room chairs on a chair-by-chair basis, and any attempt to manipulate the sale proceeds of chattels by dividing a set in this way would be ineffective for CGT purposes.

Non-UK resident individuals may sell works of art in the United Kingdom without incurring a liability to CGT in the year of disposal, although care should be taken that a gain is not deemed to arise on returning to the United Kingdom should residency be resumed within five tax years of departure from it. In addition, foreign-resident trustees do not pay CGT on the sale of chattels in the United Kingdom, but both individuals and trustees in these circumstances must be careful not to be deemed to be trading in the United Kingdom. There are also special rules concerning the benefit or enjoyment of a work of art in the

11 From 6 April 2016 the rate of CGT was reduced from 28 per cent and 18 per cent for higher and basic rate taxpayers respectively, to 20 per cent and 10 per cent for most disposals.
12 Open market value must be used for this purpose (Section 160 Inheritance Tax Act 1984).
13 The first £325,000 of a chargeable estate is taxed at zero per cent.
14 Section 262 Taxation of Chargeable Gains Act 1992 contains the details of the exemption and the restrictions that may be applicable on its use in certain circumstances.
15 The law in this area changed following the decision in Revenue and Customs Commissioners v. Executors of Lord Howard of Henderskelfe (deceased) [2014] All ER (D) 176 (Mar). The Finance Act 2015 introduced restrictions on the ability to claim this relief, limiting it to those owners who are also carrying on the trade in which the plant or machinery are used. A further restriction is that the relief is not available if capital allowances have, or could have been, claimed on the chattels. HMRC provides a full explanation of this in their manual, which is published online at https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg76722.
16 HMRC sets out its specific views on this in the CGT manual (at CG76631), which is published online at https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg76631.
United Kingdom where the chattel or chattels are owned by a company or trust and in this specialist area, advice should be sought at the earliest opportunity. Finance (Number 2) Act 2017 introduced new measures that fix the value of the benefit of enjoying works of art in the United Kingdom where the benefit is provided by a trust or company resident outside the United Kingdom. The value of the benefit is calculated as the higher of the amount paid by the person providing the benefit in acquiring the asset (i.e., the acquisition value) or, if higher, the market value at the date when the asset was first provided by that person. General anti-avoidance legislation does not impinge on this area of practice at the moment, but this position may well be reviewed again.

Where a UK resident is claiming the remittance basis of taxation, bringing a work of art into the United Kingdom will be treated as a remittance of the underlying income or gains used to purchase it, if the lifetime exemption for temporary importation to the United Kingdom (currently 275 days) is exceeded. The rule was brought into force following the Finance Act 2008 but there are some exemptions from the charge. No remittance will be triggered if the chattel was purchased out of ‘clean’ capital (i.e., the capital used did not carry an inherent tax liability derived from its original source) or if the chattels are for personal use, such as jewellery and clothing or for public exhibition, repair or conservation. Since 6 April 2012, there has been an exemption for the remittance of works of art that are brought into the United Kingdom specifically for the purposes of sale provided that the proceeds of sale are taken outside the United Kingdom within 45 days of receipt.

ii Inheritance tax

The United Kingdom provides for the conditional exemption (a form of deferral) from IHT for chattels and works of art that qualify as being of ‘pre-eminent’ importance. The exemption from IHT is granted on the condition that the owner abides by certain undertakings negotiated with HMRC. In return for the grant of conditional exemption, an owner must sign undertakings to make the relevant objects available for the public to see on at least 28 days per year, commonly known as ‘the access requirements’; furthermore, works of art must not be removed from the UK without HMRC’s consent and are subject to a duty of care. Since the Finance Act 1998 came into force, the access requirements have become more stringent and access must be advertised (on websites, in guides and relevant publications) and be given without an appointment. A reasonable charge may be imposed to defray some, but not necessarily all, of the owner’s costs of fulfilling the obligations and the owner may ask visitors to provide evidence of identity. Pre-1998, the undertakings permitted owners to limit public access to a ‘by-appointment’ basis and the merit test for qualifying

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18 Section 742D(2) Income Tax Act 2007 and/or Section. 97B(2) Taxation of Chargeable Gains Act 1992 (in both cases, as inserted into the legislation by Schedule 9, Finance (Number 2) Act 2017).


23 Land and buildings have been capable of being accepted in lieu of IHT (initially estate duty, the forerunner of IHT) since 1910 and chattels since 1956. The full details of the exemption are provided in Sections 30–31 Inheritance Tax Act 1984. Chattels may also be offered in lieu if they are historically associated with buildings that are pre-eminent (i.e., listed for their historical or architectural importance as grade I or II*).

24 The requirement is 28 days per annum for England. In Scotland, Wales and Northern Ireland the requirement is only 25 days per annum.
Notes on the Taxation of Works of Art in the United Kingdom

objects was that of ‘museum-quality’, rather than pre-eminence. HMRC is advised by a panel of experts as to whether an object meets the pre-eminence test. 25 Once an object has been accepted for conditional exemption, details of its description, but not value or ownership, are published online by HMRC.

Central to the arrangement between the owner and HMRC is the requirement that the owner will care for the conditionally exempted works of art; should the owner breach the undertakings, the exemption ends. On a breach of the undertakings, HMRC will assess the deferred IHT by reference to current rates and thresholds. This can be an unwelcome surprise to owners. In a climate of rising values for works of art, this has the potential drawback of increasing the amount of tax payable. Should the owner breach the undertakings by disposal of the work of art, there is, in addition to the IHT, a potential charge to CGT. Any CGT due is deducted from the proceeds of disposal first and IHT is charged on the net amount.

A unique feature of the IHT regime is that a taxpayer may be able to settle an IHT liability by offering a chattel or work of art to the nation in lieu of that liability. 26 The scheme, known as the acceptance in lieu scheme (AIL), has become increasingly popular as a method of settling an IHT bill. 27 The government allows an annual budget of £40 million 28 for tax to be met in this way, although that budget must be shared with the Cultural Gifts Scheme (CGS) (see below). As an incentive to use the scheme, the government provides an inducement for using the AIL scheme, in the form of a douceur (literally, a sweetener). The douceur is a fiscal incentive of 25 per cent of the total tax otherwise due on the object or objects being offered, so that their tax settlement value is increased. The AIL scheme can be used whenever an IHT liability arises, in lifetime or on death and the offeror can express a wish or condition as to the ultimate destination in the United Kingdom for the work of art. To that extent the scheme acknowledges the appropriateness of certain works of art for particular institutions (a good example is material relating to Captain Robert Scott RN, allocated to the Scott Polar Research Institute), but in expressing a wish or condition, the offerors must be mindful that the nominated institution must qualify for this purpose. 29

The mechanics of making an offer are comparatively straightforward and are designed to ensure the United Kingdom only accepts objects for which the offeror has good title and that the agreed value is fair. The offeror must provide a statement of pre-eminence, a justification of the gross value of the object, a calculation of the ‘special price’, 30 a condition report and due diligence statements in support of ownership and competence to make the offer. Together with high-quality photographs of the object, the offer documents are submitted to HMRC who advise whether the offer is competent and that a tax liability

25 The experts also opine on the acceptance in lieu scheme (see below) and the procedure is administered by Arts Council England (ACE), which works closely with HMRC (heritage team) and the professional advisers to those taxpayers involved.
26 Section 230 Inheritance Tax Act 1984. Note that only a liability to IHT or its forerunner, estate duty, can be settled; the scheme does not extend to any other tax liability, though no CGT is charged on a disposal of an object as an acceptance in lieu scheme (AIL), a notional CGT liability can affect the AIL special price calculations in some circumstances.
27 The increased use of the scheme is reflected in the tax settled through its use, which has risen from £4.9 million in 2010/11 to £26.6 million (including cultural gifts settling tax of £319,000) in 2015/16, and £25 million in 2016/17, the last year for which statistics are available.
28 The annual budget for tax settled via the scheme until 31 March 2014 was £30 million.
29 The definition of a qualifying institution is given in Schedule 3 Inheritance Tax Act 1984.
30 The special price is the tax-reduced amount that the offeror will receive for the object.
has arisen; however, HMRC delegate the evaluation for pre-eminence and gross value of the chattels to Arts Council England (ACE). A panel of experts at ACE advises HMRC on whether the pre-eminence test has been satisfied and the value is fair. Some negotiation over the value may arise during the process. An essential point when considering whether to make an offer is the question of timing, since to obtain the grant of probate any IHT due on the death must be paid first. It is not possible for the deceased’s personal representatives to anticipate the success of an offer and thereby pay a reduced amount of IHT to obtain probate. This point is often a surprise to those making an offer and inevitably impinges on the cash flow of the personal representatives.

### iii Private treaty sales

For some owners of works of art, there is the possibility of negotiating a private treaty sale of their objects to public institutions. A private treaty sale provides vendors with the opportunity to enjoy the same tax incentives as an offer in lieu, but without the restriction of having to use the proceeds to settle an IHT liability. The work of art is bought for a tax-remitted sum by the acquiring institution, having taken into account any applicable CGT and IHT. The key difference between a private treaty sale and an AIL is that the vendor receives cash for the work of art rather than having a tax liability settled. The likelihood of private treaty sales taking place in the current financial climate is comparatively limited, although institutions will make special efforts for works of art that are especially appropriate to their institution (good examples of which would be the sale of a watercolour to a gallery in the location depicted or the sale of a portrait to a gallery that already owns the pendant to it).

From the vendor’s perspective, the private treaty sale has much to recommend, as cash is paid for the acquisition, net of all tax, and, as the negotiations are conducted simply between the parties concerned, this can allow the process to conclude comparatively quickly. Private treaty sales have no bearing on the annual budget for other tax reliefs and HMRC is involved only to confirm the tax computations but otherwise is not party to the negotiations. The difficulty for many owners and indeed the acquiring institutions, is that while both parties may be willing to transact, the inevitable fundraising required to complete the sale can be difficult and time-consuming; institutions are, therefore, wary of conducting private treaty sales negotiations unless they are confident of success.

### iv The Cultural Gifts Scheme

The CGS is a new tax incentive to encourage the gifting of works of art and cultural objects to the nation was introduced in the Finance Act 2012. The government enacted fiscal support for the donation of pre-eminent objects to the nation for the first time. The incentive takes the form of a reduction against income tax or CGT for individuals and corporation tax for companies. The tax reduction is set at 30 per cent of the gross value (for an individual) or 20 per cent (for a company). The CGS rules permit the donor to spread the tax reduction over five consecutive years starting with the year of donation, as the donor wishes. Crucially the scheme does not allow the reduction against liabilities from earlier years, so there is no repayment of tax already paid, despite lobbying from interested parties during the consultation period. The scheme is not open to trustees or joint owners of objects, which limits its application further. The budget available for tax

31 Schedule 14 Finance Act 2012, which came into effect in March 2013.
reduction under the CGS is shared with the AIL scheme. While a very welcome reward for those who are philanthropically minded, the level of relief means that 70 per cent of the value of the object is foregone and to that extent a donation made under the CGS should perhaps be seen as an act of philanthropy rather than as a significant tax saving. As a comparatively new tax-reduction scheme in the United Kingdom, it will be some time before an assessment of its success can be made.

III OUTLOOK AND CONCLUSIONS

The art market and heritage sectors in the United Kingdom are significant sectors of economic activity and drive much of the UK’s tourism industry. The importance to the UK, especially London, of maintaining its position as the leading art market is a consideration for successive governments and to this end fiscal policy is comparatively benign; where possible, the government seeks to encourage private retention of works of art, thus reducing the public costs associated with keeping them in the United Kingdom. The government seeks a pragmatic solution to the competing needs of the market, the need to raise tax and the wish to retain outstanding works of art in the United Kingdom. More recently, philanthropy using cultural objects has been recognised and rewarded. It remains to be seen how much the changes in the relationship with European countries will affect the art market or if successive governments will continue in this comparatively benign approach. Nevertheless, while the art market prospers, the United Kingdom will continue to attract buyers and sellers from across the world to its experts, art dealers and auction houses.
I INTRODUCTION

i OECD developments

The OECD has become the central body charged with delivering the international agenda for greater transparency regarding asset holdings. There have traditionally been two main strands to its work in this area, both aimed at establishing internationally consistent standards. One strand focuses on information exchange for tax purposes and is led by the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum). The other strand is focused upon international standards for anti-money laundering (AML) regulations. The work here is led by the Financial Action Task Force (FATF). While the Global Forum and the FATF remain distinct bodies within the OECD, they nevertheless work closely with each other. A third major work stream, known as base erosion and profit shifting (BEPS), led by the OECD Committee on Fiscal Affairs, has come to the fore. This work stream is focused on tackling corporate tax planning strategies that artificially shift profits to low- or no-tax locations where there is little or no economic activity. All three initiatives have now gained considerable momentum thanks to the strong support of most of the world’s major economies.

ii The FATF

The FATF published revised recommendations for minimum national AML standards (generally referred to as the FATF’s 40 Recommendations) in February 2012. The 40 Recommendations were the result of long and at times heated negotiations, and their publication has prompted a period of very intensive implementation work in many of the major economies. As a result, a variety of jurisdictions are now working on significant new legislative proposals in the AML area.

It was clear at an early stage that many of the most fundamental changes flowing from the FATF Recommendations would result from new requirements intended to improve the transparency of beneficial ownership. While the proposed new regime for trusts (outlined in FATF Recommendation 25) contains only relatively limited changes in this area, the changes for companies (outlined in Recommendation 24) are much more fundamental.

The FATF now requires that countries should ensure that companies either obtain and make available information on their beneficial ownership or ensure that there are alternative
mechanisms, such as registries, in place so that beneficial ownership of a company can be determined in a timely manner by competent authorities. Countries are also required to ensure that one or more natural persons, or DNFBPs, are authorised by the company and accountable to competent authorities for the provision of beneficial ownership information to competent authorities and for giving assistance to competent authorities.

The United Kingdom’s response to this new global standard has been to enact reform of procedures for the collection and holding of information on people with significant control (PSCs) via the Small Business, Enterprise and Employment Act in 2016. It is notable that this legislation is not just aimed at meeting the requirements of FATF Recommendation 24, but goes significantly further. Not only does it establish a statutory register of beneficial owners of companies (in the form of PSCs) but it also gives a right of public access to the beneficial ownership information rather than confining access to competent authorities. Thus, the Regulations require companies to hold information on their own beneficial ownership and respond to any reasonable public request for information from the register as well as file beneficial ownership information with the national registrar of companies.

The UK focus on ensuring public access to corporate beneficial ownership information raises the issue of what information should be shown on the corporate register where the beneficial owner of a corporate entity is a trust. The initial suggestion was that the corporate register should show the name of the trust, the trustees and the beneficial owners of the trust. Ultimately, however, the argument that in practice many trusts are established to protect vulnerable beneficiaries and that publication of the names of such beneficiaries would potentially leave them at risk was accepted. The Regulations therefore call for the corporate register, where the beneficial owner is a trust, to show simply the names of the trustees and anyone who has the ‘right to exercise, or actually exercises, significant influence or control over the activities’ of the trust or company. The Regulations apply to all UK-incorporated companies, including limited liability partnerships, as well as to individuals who hold a UK company through an overseas holding company, and they will be obliged to register unless they hold a minority interest – in which case they will be exempted.

The UK approach to implementing the FATF Recommendations is particularly notable since the UK has indicated that it would like the UK, the Crown Dependencies and Overseas Territories (CDOTs) to ‘move forward together (with the UK) in raising standards of transparency globally’ and that ‘making company beneficial ownership information open to the public is by far the best approach’. Most CDOTs have now created or are in the process of creating registers of beneficial ownership, although there may be differences with regard to whether they are centralised or publicly available.

Publicly accessible registers of beneficial ownership are also a key feature of the Fourth EU Anti-Money Laundering Directive (4 AMLD), which entered into force and appeared in the Official Journal in June 2015. The Directive, which was implemented by Member States on 26 June 2017, goes well beyond FATF requirements. For corporates and other legal

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3 Designated non-financial businesses and professions.
entities, Article 30 requires that Member States ensure that beneficial ownership information is held in a central register and that the information held on the register is available to competent authorities, obliged entities and ‘any person or organisation that can demonstrate a “legitimate interest”’. A ‘legitimate interest’ is to be interpreted by each Member State but the general expectation is that they will allow public access, in line with the UK’s PSC register approach.

Article 31 takes a different approach for trusts. Trustees must hold beneficial ownership information and this will be held in a central registry ‘when the trust generates tax consequences’. Law enforcement and competent authorities will have full access to the central registry and a Member State may opt to allow public access to the register. HMRC’s new online ‘Trust Registration Service (TRS) was launched in July 2017. The TRS compels trustees of an express trust that incurs ‘relevant’ tax liabilities to register their trust, or update existing trust data on the register. The relevant taxes are UK income tax, capital gains tax, inheritance tax, stamp duty land tax, stamp duty reserve tax, and (in Scotland) land and buildings transaction tax. The United Kingdom was the first of the Member States to comply with its 4 AMLD obligations and some Member States have still not managed to transpose the Regulations into their national law.

The Directive additionally requires the Commission to identify third-country jurisdictions that have strategic deficiencies in their national AML regimes (‘high-risk third countries’). It gives the Commission a wide degree of discretion on how to define such high-risk countries and it has been suggested that this will be used to pressure near neighbours of the European Union and significant financial centres to adopt similar AML procedures to those laid out in the Directive.

In the wake of terrorist attacks in France and the Panama Papers data leak of 2016, the European Union decided to revise the 4 AMLD before it had even been implemented. On 14 May 2018, following several months of trialogue negotiations, the Council of the European Union adopted the amendments now known as the Fifth Anti-Money Laundering Directive (5 AMLD). The Directive will give full public access to information on the beneficial owners of firms operating within the European Union, although the corresponding information for trusts will be limited to ‘obliged entities’ and those with a ‘legitimate interest’, the definition of which is governed by the law of each Member State where the beneficial ownership information of the trust or similar legal arrangement is registered. It is unclear how the United Kingdom will choose to interpret the definition and whether it will be extended beyond the scope of law enforcement agencies and competent authorities.

The United Kingdom’s decision to leave the European Union creates uncertainty as to the future force of EU directives in the United Kingdom. It is likely that it will be excluded from negotiations regarding EU regulations but may nevertheless be pressured into implementing EU legislation to preserve access to EU markets. The transposition deadline of 5 AMLD falls after the United Kingdom’s projected exit from the European Union in March 2019, and the post-Brexit transitional period, agreed in March 2018, is set to expire on 31 December 2020. During this time, EU law will continue to apply to the United Kingdom and the new Directive would have to be implemented. In the meantime, it appears that Europe has moved decisively towards publicly accessible registers to meet its obligations under the revised FATF Recommendation.

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The United States seems to be taking a different approach. It is now an FATF requirement for governments to conduct an AML national risk assessment and it has published its first such assessment since 2005. The assessment acknowledges that ‘the United States has a large, complex and open financial system – making it a destination for legitimate trade and investment but also a target for illicit activity and actors’. Rather than registers, however, the US approach rests on the twin pillars of extensive regulation of financial institutions alongside well-equipped enforcement and supervisory bodies. The assessment concludes that, in the case of the United States, ‘law enforcement generally has access to the information it needs to investigate money laundering cases in the United States, but cooperation and transparency are not always present in other countries’.

However, in June 2018, the US Department of the Treasury Financial Crimes Enforcement Network (FinCEN) published an advisory to financial institutions reinforcing their obligations under the Bank Secrecy Act to report suspicious transactions by political figures and related persons across the United States: ‘Theft and other bad acts committed by corrupt senior foreign political figures undermine democratic institutions, destabilize economies, and erode societal foundations,’ said FinCEN Director Kenneth A Blanco. ‘FinCEN is committed to continuing its fight against corruption and those who use the U.S. financial system to further their nefarious activities at the expense of innocent people.”

The FATF is currently conducting mutual evaluations of national implementation of the FATF Recommendations. A mutual evaluation report provides a detailed analysis of a country’s system in place designed for preventing criminal abuse of the financial system. At the time of writing, the FATF has reviewed over 90 countries and most of these have since made the necessary reforms to address their AML weaknesses and have been removed from the process. In addition, the anti-BEPS measures that have been implemented by the G20 and OECD have furthered the objective of retaining taxation in the appropriate jurisdictions where the profits have been generated.

The United Kingdom will be evaluated for the first time this year against the internationally enhanced standards that were introduced in 2012 and it will culminate in a published mutual evaluation report in December 2018. The report will analyse the United Kingdom’s compliance level compared with the FATF Recommendations and will be offered feedback on how to strengthen its security measures. The United Kingdom’s mutual evaluation is expected to take place in autumn 2018.

II OECD GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES

The Global Forum is the major international body for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax area. The Global Forum was originally established in the early 2000s but was significantly restructured in 2009 and now has a much wider membership comprised of 126 jurisdictions (plus the European Union).

The restructuring of the Global Forum resulted in a major expansion of the Global Forum’s work programme, with the main objective being the establishment of a comprehensive

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network of bilateral tax information exchange agreements (TIEAs). TIEAs are based on the principle of tax information exchange on request, reinforced by a peer review process to examine both the availability of the necessary information for tax information exchange and the effectiveness of the processing of requests for information exchange.

The arrival from the US of the Foreign Account Tax Compliance Act (FATCA), based on automatic information exchange, nevertheless changed the basis of the international debate on tax information exchange. In spring 2013, the G20 Finance Ministers and Central Bank Governors endorsed automatic exchange, as opposed to information exchange on request, as the new global standard for tax information exchange and requested the OECD, working with the G20, to develop a new standard based upon automatic exchange of information.

The OECD’s model, generally known as the Common Reporting Standard (CRS), is based heavily on the Model 1 intergovernmental agreements (IGAs) many jurisdictions have concluded with the United States. The CRS model was first published in outline in February 2014, with further details being published in July 2014. The OECD’s approach has now been endorsed by all 34 members of the OECD and in total over 101 jurisdictions have committed to first exchanges by 2017 and 2018. The only major outlier is therefore the United States, which remains committed to FATCA and declines to implement the CRS on the basis that FATCA is adequate for its needs.

The legal basis for the CRS highlighted by the OECD is the Multilateral Convention on Mutual Administrative Assistance in Tax Matters; currently, 121 jurisdictions participate in the Convention, including all members of the G20. The Convention requires separate agreements between the competent authorities of the various parties, with automatic exchange of information then taking place on a bilateral basis between the relevant parties. This is seen as providing an important protection since jurisdictions will be able to decline to enter into agreements with any party where there are significant concerns about ensuring the confidentiality of data exchange or the uses that will be made of information exchanged for tax purposes. There is, however, a proposal being currently worked on to provide a standardised assessment of each participating jurisdiction’s ability to ensure appropriate use of any tax data received as part of a peer review type process.

Certainly in this context the OECD itself is keen to stress the safeguards inherent in both the Convention and the CRS and make it clear that where the required standards ‘are not met (whether in law or in practice), countries will not exchange information’. It is notable, however, these protections, plus the presumption of reciprocity, are coming under criticism from those campaigning on behalf of developing countries on the grounds that they may in reality mean that many poorer developing countries are denied access to the CRS. The OECD acknowledges the ‘developing countries may face particular capacity issues as regards automatic exchange of information’ and notes that the Global Forum has been asked to work with the OECD Task Force on Tax and Development and others to assist with capacity building in developing countries.

Alongside capacity building in developing countries, the Global Forum will now be responsible for monitoring and reviewing the implementation of the CRS. There are global concerns that the information being exchanged under CRS might be leaked; therefore, the monitoring of the robustness of each jurisdiction’s system will be essential. The precise methodology by which implementation will be monitored has yet to be decided, but it seems likely that the peer review process established for the previous global standard, tax information exchange on request (via TIEAs) will now be extended to the new global standard, automatic exchange of tax information.

The arrival of the CRS as the new global standard for exchange of tax information has implications for some of the other tax information exchange initiatives that have been developed. It is envisaged, for example, that the arrival of CRS reporting in 2017 will effectively replace the FATCA-style IGAs the United Kingdom has with the CDOTs.

Industry has broadly welcomed the convergence on a single standard of information exchange. Despite the OECD’s attempts to create a global standard for the automatic exchange of information, a significant number of jurisdictions have introduced local variations to reporting requirements. This inconsistency has hindered financial institutions in preparing for CRS. Several jurisdictions had threatened to develop their own versions of FATCA and a common approach clearly simplifies implementation. The major question mark, however, remains over how the United States will approach the OECD’s CRS initiative; it is unlikely to move away from FATCA and adopt the CRS process. The US position, however, is that the Model 1 IGAs entered into under FATCA ‘acknowledge the need for the United States to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions’. In spite of political commitment from the United States to ‘advocate and support’ legislation to give effect to reciprocal information exchange, there is yet little prospect of any real progress here at the political level, although at the same time several non-US tax authorities are indicating that they are now receiving useful tax information from the United States even if this is not yet as comprehensive as it would be under the CRS.

The OECD has released Model Mandatory Disclosure Rules (MDR) for CRS Avoidance Arrangements and Opaque Offshore Structures in 2018. The design of these model rules draws extensively on the best practice recommendations in the BEPS Action 12 Report while being specifically targeted at these types of arrangements and structures. The rules will now be submitted to the G7 presidency for formal approval and then it is up to national governments on how they implement them. The OECD has stated that the new rules do not affect a jurisdiction’s CRS legislation, rather the MDRs are information-gathering tools that seek to bolster the integrity of CRS.

III  BEPS

The other significant project that the OECD has been working on is the BEPS programme. This is the umbrella term used for the OECD’s work on measures to inhibit the shifting of corporate profits to low-tax or no-tax jurisdictions where there is little or no economic activity. The OECD is currently in the process of developing a series of action plans covering various
aspects of what is acknowledged to be a contentious and complex issue. Sufficient progress has been made, however, and the Treasury Department and the Inland Revenue Service have finalised a rule requiring US parent companies of multinational public and private companies to provide their financial data to the IRS on a country-by-country basis with other OECD countries. Tax authorities around the world are hoping that the intergovernmental exchange mechanisms will identify companies that are shifting their profits into tax havens, which will instigate further investigation.

The primary focus of BEPS is clearly on the corporate sector, but many private client structures will have a corporate component. The intention is clearly that corporate structures will now also be transparent and not used as tools of aggressive tax planning strategies to move income from one jurisdiction to another. The OECD and G20 have welcomed all interested countries and jurisdictions that are ready to commit to the BEPS programme and, to date, over 80 jurisdictions have signed up to express their willingness to prevent BEPS by multinational enterprises. The OECD celebrated the signing ceremony, saying that ‘the signing of this multilateral convention marks a turning point in tax treaty history’.21

IV OUTLOOK

The near-simultaneous implementation of major new processes for the collection of beneficial ownership information, the automatic exchange of tax information and improved transparency in the corporate sector, is likely to have significant consequences, both intended and unintended. The concept of ‘beneficial ownership’, always a problematic one in the trust context, is beginning to shift from AML to tax, with both FATCA and CRS using beneficial ownership, rather than tax liability, as the basis for the collection of tax information. Automatic exchange will also see information on wealth, rather than income, being reported, in many cases for the first time.

There have already been some teething problems with CRS reporting, owing to a significant number of jurisdictions having introduced local variations to reporting requirements. This global inconsistency has hindered financial institutions in preparing for CRS and the OECD may be required to revisit their guidance. As we approach full implementation of the CRS in 2018, the central issues under debate in terms of the limits to transparency are likely to shift. Automatic exchange of tax information on a broad basis will unleash a deluge of confidential and highly sensitive personal financial information for transmission around the world. Differing jurisdictions may have differing issues to consider under these circumstances. Some jurisdictions may also need to consider if their data-protection laws are consistent with the commitments they have made with respect to CRS implementation, while others may have to consider if the confidentiality obligations contained in their trust and banking laws are consistent with their CRS commitments.

In the long run, however, greater transparency as to both income flows and wealth holdings may also begin to influence how tax authorities structure the tax system to maximise tax yields. As intelligence improves on international tax-planning strategies, it seems inevitable that tax authorities will take action to block those they deem to be overly aggressive or otherwise unacceptable. The OECD has positively affirmed that ‘tax matters and

21  OECD Secretary-General Angel Gurria.
transparency are finally front and centre in public discussions about fairness, good governance and responsible business (and individual) conduct. In short, global transparency, by way of reporting and exchange of tax information, continues to dominate the industry and remains a high political focus.

I INTRODUCTION

Argentina is home to many wealthy individuals and families. Only a small group of these have received sophisticated technical advice in matters of tax planning and estate succession. Consequently, there is an important group of wealthy people, mainly concentrated in the interior provinces of the country, lacking an adequate tax, financial and succession plan for their estates.

II TAX

i Income tax

Income tax is a national tax applied on the worldwide income obtained by individuals and legal entities domiciled in Argentina and Argentine branches of foreign entities.

Foreign resident individuals are taxed only on their Argentine income source through a withholding system and based on their presumed income. In general, foreign individuals are taxed at a 35 per cent flat rate.

Domestic individuals are taxed upon a sliding scale ranging from 5 per cent to 35 per cent depending on the income subject to taxation.

On 29 December 2017, Law No. 27,430 was enacted, introducing several modifications to the former tax regime, especially with regard to financial investments. To date, this reform has not been fully regulated.

As a result of these amendments, capital gains from sales and interest derived from sovereign and private bonds, debt securities and other similar securities are subject to a 5 per cent rate (if they are nominated in Argentine pesos, without an adjustment provision) or 15 per cent rate (if they are not), for both domestic and foreign individuals.

In the case of foreign individuals, income (trading or interest) derived from securities listed in Argentina – except for Central Bank bonds – is generally exempt from income tax, provided the beneficiary does not reside in, or the funds are not from, a jurisdiction deemed not cooperative, pursuant to Argentine legislation. If this last condition is met, however, the income would be subject to a 35 per cent rate.

In the case of Argentine individuals, capital gains from the sale of shares or equity interest is subject to a 15 per cent rate on net income. The sale of shares or equity interest

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1 Miguel María Silveyra is a partner, and Valeria Kemerer and Enrique López Rivarola are associates at Estudio Beccar Varela. Tadeo I. Fernandez and Gustavo Papeschi also collaborated with the preparation of this chapter.
by Argentine individuals or foreign entities is exempt from capital gains tax in the following cases: when the shares are placed through a public offering authorised by the National Securities Commission (CNV); when the shares are traded in stock markets authorised by the CNV, under segments that ensure price-time priority and interference of offers; or when the sale, exchange or other disposition of shares is made through a tender offer regime or exchange of shares authorised by the CNV.

Foreign beneficiaries are either subject to a 15 per cent or 13.5 per cent rate on the gross amount paid for shares or equity interests, unless the exemption for listed securities mentioned above is applicable. Indirect sales of Argentine entities (i.e., sales of foreign companies that owns shares of Argentine companies) can also be subject to income tax in Argentina, if certain requirements are met.

Capital gains from the sale of ADS is subject to 15 per cent income tax in the case of Argentine individuals. Capital gains of foreign individuals are exempt from this tax if the underlying shares are issued by Argentine entities and are authorised to be listed by the CNV.

ii Personal asset tax

With regard to taxes on property, all Argentinean residents are subject to personal assets tax on their worldwide assets. The taxable base is, in principle, the value of such assets (except for a few exceptions, debts are not deductible). Foreign residents are subject to this tax only upon their assets located in Argentina.

Personal assets tax applies when the assets owned by the taxpayer, as of 31 December of each fiscal year, exceeds the amount of 1.05 million Argentine pesos. The applicable tax rate for Argentinean residents is 0.25 per cent.

In the case of individuals, deposits in Argentine banks and Argentine sovereign bonds are exempt from tax. However, other securities are usually taxed. In the case of ownership of shares of Argentine companies, the tax is paid by the company.

iii Gift and succession taxes

In Argentina, only the province of Buenos Aires has gift and inheritance taxes. There is currently no such tax nationally and in the remaining provinces.

In Buenos Aires, tax is levied on any asset received free of charge, such as gifts, donations, inheritances and legacies, if received by residents or, alternatively, if they involve assets deemed to be located in the province.

In the case of shares and equity interests, these assets are deemed to be located in such province (and, therefore, taxed regardless of the residence of the beneficiary) if the company is incorporated in such jurisdictions, if the shares are physically located there or, controversially, if the companies own assets within the province (and in such proportion). For tax assessment purposes, the shares will be valued by the net asset value of the latest closed financial statements.

The applicable rates vary between 1.6026 per cent and 8.7840 per cent, depending on the relationship between the beneficiary and the contributor and on the value of the assets. The tax’s threshold varies depending on this relationship and is usually adjusted annually.

iv Issues relating to cross-border structuring

Local residents can register for foreign tax credits, taxes paid abroad that are deemed equivalent to income tax and personal assets tax, up to the amount of the tax payable in Argentina for the income or assets located or obtained abroad.
In the case of Argentine residents that are stockholders of foreign entities, tax credits for taxes paid abroad for direct or indirect investments in foreign companies can be offset against the payable income tax in Argentina on dividends paid by such entities. In the case of direct stockholders, the local taxpayer must be able to prove ownership of at least 25 per cent of the foreign company’s equity. In the case of indirect shareholders, a minimum 15 per cent ownership must be proved. Foreign taxes paid can be used as a tax credit up to a second-tier subsidiary. In this case, the subsidiary cannot be located in a country deemed to be a tax haven, pursuant to Argentine regulation.

In the case of investments involving derivatives, there is some controversy regarding the potential use of income taxes paid abroad as credits. Income deriving from derivatives is deemed to be an Argentine income if its recipient is an Argentine resident. Domestic rules regarding foreign tax credits establish they can only be used by a local resident if they are linked with foreign source income. Therefore, although debatable, these credits could not be offset against income tax derived from this type of operation, unless a specific double taxation treaty states otherwise.

Argentina has double taxation treaties in force with Australia, Belgium, Bolivia, Brazil, Canada, Chile, Denmark, Finland, France, Germany, Italy, Mexico, the Netherlands, Norway, Russia, Spain, Sweden, Switzerland, the UK and Uruguay. These treaties may set forth limitations to the country’s tax jurisdiction in relation to income or personal asset tax and special rules regarding foreign tax credits. Except for the treaty with Bolivia and Uruguay, Argentine double taxation treaties are based on the Organisation for Economic Co-operation and Development (OECD) and UN tax models.

v  Issues impacting entrepreneurs as holders of active business interests

Argentine corporations and limited liability companies are not pass-through entities pursuant to Argentine legislation and, therefore, must report their income and pay the resulting income tax at a 30 per cent rate (25 per cent for tax periods commencing after 1 January 2020). These two types of entities comprise the vast majority of Argentine companies.

Payment of dividends and utilities by those entities is subject to an additional 7 per cent income tax in Argentina. A 13 per cent rate would be applicable for profits previously taxed at the above-mentioned 25 per cent rate (unless a double taxation treaty limits it).

However, dividends paid by foreign companies are subject to income tax in the case of domestic individuals, at a 5 per cent to 35 per cent rate (unless an applicable double taxation treaty establishes otherwise). The disbursement of dividends by the foreign company to a domestic individual is not subject to income tax if the beneficiary can prove that the profits that are paid out derive from dividends or utilities originally paid from Argentina to such foreign company (that have been taxed in Argentina from the same individual or a local company).

III  SUCCESSION

i  Applicable jurisdiction and law

On 1 August 2015, a new Civil and Commercial Code (CCCN) entered into force and replaced both the former Civil Code and the Commercial Code. As a consequence, the inheritance, matrimonial and the private international law rules have been significantly amended, and there is still no sufficient case law on the issues addressed herein to fully foresee the final interpretation that the new provisions may entail.
According to the CCCN, succession to the estate of a deceased person is governed by the law of the country where the decedent was domiciled at the time of his or her death, regardless of the decedent’s or his or her inheritors’ nationality. However, and regardless of the above general rule, Argentine law will mandatorily govern all issues concerning real estate located in Argentina and precludes the application of any foreign law. The CCCN further provides that the same law governs the content and validity of wills.

Regarding jurisdiction, the general rule is that the judge sitting where the deceased was last domiciled shall have jurisdiction to hear the case. There is an exception to this rule when real estate is located in Argentina, in which case the judges sitting at the place where the real estate is located have jurisdiction to hear the case.

It is worth pointing out that, pursuant to the Constitution, international treaties pre-empt domestic law. However, only two treaties are relevant for our analysis (i.e., the Treaties on International Civil Law (Montevideo) of 1889 and 1940), and given their limited territorial application, we will just point out that they set forth that the applicable law will be the law where the deceased person’s assets were located at the time of his or her death and that wills granted through a public deed in any Member States of the treaty will be valid in all other Member States.

Although Argentina signed the 1989 Hague Convention on the Law Applicable to Succession of the Estates of Deceased Persons, this convention is not yet effective, and has had a low rate of acceptance.

Argentina has not signed the 1961 Hague Convention on the Conflicts of Laws relating to the Form of Testamentary Dispositions.

ii Outline of Argentine succession system

Forced heirship system

Argentina has a forced heirship system that limits the individual’s ability to freely dispose of his or her property by gifts inter vivos or wills. In this regard, according to the law, individuals are able to dispose of their property by any of these means as long as a minimum share of their estate (reserved share) is reserved for their spouses, descendants and ascendants (forced heirs).

Descendants have the right to a reserved share of two-thirds of the decedent’s estate, whereas ascendants and spouses have the right to reserved shares of half of the estate of the deceased. If there are heirs entitled to share the state with different reserved shares (e.g., spouse and descendants), the highest reserved portion applies globally.

The general rules described above are, however, significantly different when there are disabled heirs. In that case the law allows the individuals to improve such disabled heirs’ portion by reducing the reserved share of the other heirs by up to a third.

The reserved shares are estimated using the aggregate value of the estate at the time of the decedent’s death and the computable gifts provided for each of the forced heirs. In the case of the spouse, the value of the marital assets belonging to the surviving spouse shall be subtracted from the base of calculation.

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2 CCCN, Article 2,644.
3 Montevideo Treaty of 1889, ratified by Argentina, Bolivia, Colombia, Paraguay, Peru and Uruguay, while Montevideo Treaty of 1940, only by Argentina, Paraguay and Uruguay.
4 CCCN, Article 2,445.
5 CCCN, Article 2,448.
6 CCCN, Article 2,445.
Beyond the reserved shares, individuals may freely dispose of their property, either by gift during their lifetime, or by means of a will. This disposable portion of the individual estate is called the ‘available share’.

Notwithstanding all of the above, in limited and serious cases listed by the CCCN, forced heirs may be deemed unworthy of inheriting and, therefore, can be excluded from the succession (e.g., when any forced heir is judged to be the author, accomplice or participant in an intentional crime offence against the deceased, his or her honour, sexual integrity, liberty or property).

**Order of vesting**

The law also determines how heirs are vested over the deceased’s estate:

\[ a \] Descendants: they exclude the ascendants and concur with the spouse. Concurrence among descendants and the spouse is limited to the decedent’s non-marital property. Spouses do not concur as heirs with regard to marital property because they receive their half of such property as a result of the dissolution and liquidation of the marital property community. The decedent’s own property is distributed in equal portions among all of the descendants and the spouse. Among themselves, descendants equally inherit the deceased’s estate. Grandchildren inherit by representing the predeceased offspring.

\[ b \] Ascendants: if there are no descendants, ascendants concur with the spouse over the non-marital property in halves. Among themselves, ascendants equally inherit the deceased’s estate. Closer generations exclude further ascendants.

\[ c \] Spouse: the spouse may concur with descendants or ascendants.

\[ d \] Collateral relatives: if no descendants, ascendants or spouse exist, collateral relatives, until the fourth degree of relationship, are equally entitled to the estate.

**Legal actions to protect the inheritance rights**

Rightful heirs have two options to protect and demand compliance with their inheritance rights.

First, there is an equalisation action that seeks to protect equality among heirs within the same rank of concurrence. This action entitles any rightful heir to claim that certain kinds of gifts received by any other heir during the decedent's lifetime should be deemed as an 'inheritance advance' and therefore as part of the rightful portion of the inheritance corresponding to this heir. The result of this equalisation action would only be a credit arising out of the acknowledgement that another rightful heir has received from the decedent and during his or her lifetime certain assets that shall be deemed an 'inheritance advance' to such heirs.

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7 CCCN, Article 2,281.
8 CCCN, Articles 2,424 to 2,443.
9 CCCN, Article 2,446.
10 CCCN, Article 2,448.
11 CCCN, Article 2,434.
12 CCCN, Article 2,431.
Second, there is a reduction action that seeks to protect the reserved share and is meant to reduce any devise or bequest made in the will or as a gift *inter vivos* by the decedent to the extent that it prevents a forced heir’s right to his or her reserved share. This action entitles any forced heirs to file a claim against those heirs, legatees and grantees that have received gifts and legacies in excess of their rightful portion or in excess of the available share to have their legacies reduced or their gifts returned. Reduction affects wills dispositions first, and in case their reduction were not enough to recompose the reserved share of the claimant, affects gifts, beginning by those more recent in time.

It may be reasonably construed that the reduction action regarding gifts is subject to a 10-year statute of limitation counted from when the heir, legatee or grantee took possession of the gifted asset. With regard to the reduction action against bequests or devises made in a will, no specific statute of limitations is provided for. It may be argued that the generic statute of limitation (i.e., five years) applies. However, it could also be construed that the applicable statute of limitation is 10 years (the term for accepting an inheritance), or even 20 years (the adverse possession term for real property).

**Agreements on future inheritances**

Any general agreement entered into by and between future heirs during the deceased’s life is null and void.

However, the CCCN has allowed agreements over future inheritances as long as the covenants only fall over the equity of companies or other business ventures with the aim of maintaining the management unity or preventing or solving conflicts, and the dispositions do not deprive forced heirs of their reserved portions, nor do they affect the spouse or third parties’ rights.

**iii Inheritance proceedings**

After an individual has passed away, a judicial proceeding must commence (the inheritance proceeding) with the purposes of identifying the heirs, determining the content of the inheritance, collecting any outstanding credit, paying the debts, bequests and devises, and filing certain assets before the public registries.

The inheritance proceeding is filed before the judge with jurisdiction in the decedent’s last domicile or, in the case of real property located in Argentina, where the assets are located. If real property is located in several of the Argentine provinces, the applicant may (but is not required to) file its application in any of those jurisdictions.

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13 Relevant case law (although prior to the CCCN) has ruled that: (1) the fact that a foreign trust (in the analysed case, an UK trust) was subject to foreign law, does not prevent the transfer from being subject to Argentine law for the purposes of an inheritance proceeding; and (2) to the extent that the beneficiary had the right to demand the delivery of the proceeds of the trust and that such trust was incorporated for no consideration against the beneficiary, such trust should be deemed a gift under Argentine law (for the purposes of the equalising and reduction action).

14 CCCN, Article 2,459.

15 CCCN, Article 2,560.

16 CCCN, Article 1,010.

17 CCCN, Article 2,335.

18 CCCN, Articles 2,336 and 2,643.
The administration of the estate must be carried out by an administrator, to be appointed either by the testator or the heirs acting by majority. Non-resident individuals may be appointed as executors of the estate.

The length of inheritance proceedings varies according to the complexity of the case. A straightforward case (e.g., with few assets located in urban areas and no minors involved) can take approximately five to six months, from its commencement to the recording of the heirs’ title at the relevant registries.

**iv Wills**

Wills are unusual in Argentina, and are generally only made by wealthy individuals. Most people die without making a will, in which case the rules on intestacy described above apply.

If made in Argentina, a will is only valid when made pursuant to the formalities provided by Argentine law.

Therefore, a will made by a foreigner in his or her country’s consulate in Argentina may not be considered valid by an Argentine court, with the exception mentioned above in the Montevideo treaties for the signatories of such treaties.

Under general principles contained in the CCCN, a will made abroad is enforceable if it complies with the law of the place of its making, the testator’s place of residence or the country of the testator’s nationality.

**v Marital property regime**

The conflict of laws rules provided in the CCCN states that the marital property regime – in all that is not forbidden on matters of property by the law of the place where the assets are located – is ruled by the spouses’ agreement. Spouses’ agreements were not valid before the CCCN and the only possible regime was the communal property regime. According to the CCCN, if the agreement was entered into prior to the marriage, it will be governed by the laws of the first marriage domicile. The agreements entered into after the date of marriage will be governed by the laws of the spouses’ domiciles at the time of the signing of the agreement.

Under the CCCN, the future spouses have the possibility (by entering into a marriage agreement) of choosing between a communal property regime or a separate property regime. The CCCN\(^\text{19}\) provides that, if no marriage agreement is made or the marriage agreement does not set forth any provision regarding the property regime, the traditional shared property regime will be applied. Conventions may be created for the purpose of: designation and appraisal of the goods that each of the future spouses brings to the marriage; admission of debts; donations made between each other; or choice of marriage regime.

The CCCN also provides that marriage agreements must be executed by means of a public deed to be valid, but for the marriage agreements to be effective towards third parties, the marriage certificate must include a note stating the regime chosen. If the spouses decide to change the regime, the amendment must also be made through public deed, after one year of the marriage agreement’s date. Creditors affected by this change may object within one year of the date they became aware of the change.

When a marriage is terminated (by death or divorce), the assets that qualify as shared property are grouped together and, after the applicable liabilities and claims of each spouse have been cancelled, divided and distributed equally between the spouses.

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\(^{19}\) CCCN, Article 463.
vi  Same-sex marriages and cohabitation

Argentine law recognises marriage between same-sex couples, so the same marital property regime applies in such cases.

The CCCN also recognises certain rights to cohabitees provided they have been together for at least two years.

Through the means of cohabitation agreements, cohabitees will be able to regulate different aspects of their life together, such as economic aspects and other responsibilities.

The CCCN also provides protection for the family home and, in the event of the death of one partner, the survivor is granted the right of free housing in the home they shared for a period of two years. However, the CCCN does not recognise cohabitees’ inheritance rights over their partner’s assets.

IV  WEALTH STRUCTURING AND REGULATION

i  Commonly used vehicles for wealth structuring, such as trusts, foundations or partnerships

As mentioned in Section I, only a small group of wealthy people has taken advantage of sophisticated structures to improve their estate and business organisation from a tax and succession law standpoint. Within this group it is common to see structures that take advantage of foreign trusts and foundations, combined with other structures that are more frequently used, such as company reorganisations and gifts inter vivos (usually structured in a way by which the grantor withholds the legal right of using and enjoying the fruits or profits of the property until his or her death). After the CCCN entered into force, the change of marriage regime emerged as another instrument for estate reorganisation.

ii  Legal and tax treatment of commonly used vehicles and typical advantages and disadvantages to personal ownership or control

Before Law No. 27,430 was passed, in the case of Argentine residents that invest their wealth abroad, typically either a corporation or a trust was incorporated in a foreign jurisdiction.

No controlling foreign corporation rules were applicable in the case of foreign corporations (or entities that issue shares), if these entities were incorporated in jurisdictions deemed to be ‘cooperative for fiscal transparency purposes’ and, therefore, Argentine income tax was paid when (and if) such entities paid to dividends to their Argentine shareholders. However, in these structures, the shares owned by the individual were still subject to personal assets tax.

Another traditional structure used to benefit from this tax deferral was the creation of an irrevocable trust abroad. The main advantage of this type of trust was that the settlor would not have to pay personal assets on the assets transferred to the trust, provided that it is not disregarded by the tax authority and the assets deemed to be owned by him or her, as an application of the substance over form principle.

Law No. 27,430 further reinforced controlling foreign corporation rules in Argentina and limited these tax deferral structures. Controlled trusts incorporated abroad for asset management purposes are deemed to be fiscally transparent. The same treatment is applicable to foreign companies that are controlled by Argentine residents, if they do not have sufficient means to carry out their formal purpose or if more than 50 per cent of their income is deemed passive income and if those entities were subject to an income tax in the jurisdiction where they are incorporated that is at least 75 per cent lower than Argentine income tax.
It must be pointed out that these new controlling foreign corporation rules have not been fully regulated to this date and that this regulation is essential for tax planning purposes. Besides, tax-free reorganisations procedures are typically used to split family companies between their members, without any tax burden. These are complex procedures that require the compliance of several formal and substantial requirements, among which stand out the prohibition for the owners to sell the reorganised entities or change their activities within two years of the reorganisation.

Finally, to avoid commencing an inheritance proceeding and the costs involved (court tax and attorney's fees), it is customary for individuals to grant gifts *inter vivos*.

### iii Applicable anti-money laundering regime

The Argentine Criminal Code and Law No. 25,246 are the main regulations that govern and punish anti-money laundering offences. This Law sets forth a list of 'regulated entities' (involving both public and private entities, as well as natural persons) that are obliged to, among other duties, to perform know-your-client procedures and report any suspicious operation to the Financial Information Unit.

Likewise, pursuant to anti-money laundering law, persons or legal entities that act as trustees or that own or are affiliated with trust accounts, trustors and trustees in connection with trust agreements, must carry out anti-money laundering measures, which include, as mentioned, but are not limited to, know-your-client procedures, issuance of an anti-money laundering manual and training employees on the subject.

Argentina is a member of the Financial Action Task Force on anti-money laundering in South America, the Egmont Group and the Group of Experts for the Control of Asset Laundering, as well as other anti-money laundering-specific organs within the region and the OECD.

### V OUTLOOK AND CONCLUSIONS

Even though there are some wealthy Argentine individuals and families that have been duly assessed in order to plan their estate organisation from a financial, tax and succession standpoint, a significant portion of Argentina’s wealthy population still lacks accurate advice with regard to its estate planning.

In 2016, a tax amnesty took place in Argentina, and in 2017, a significant tax reform was enacted. This, and the fact that anti-money laundering regulation is becoming tighter, may cause individuals to start structuring the organisation of their assets and succession.
I INTRODUCTION

Austria is a small but wealthy jurisdiction in the middle of Europe. As a member of the European Union, the Schengen Area and the Eurozone, it provides an attractive environment for wealthy people from Austria and abroad.

According to a recent analysis by the Austrian Chamber of Commerce, more than 50 per cent of Austrian businesses are organised as family businesses under the EU definition. They account for almost two-thirds of all Austrian employees and 57 per cent of sales in Austria. Many of these families developed their Austrian local businesses into international players and continue to look for suitable solutions, not only for further evolving their business, but also for passing their wealth or enterprises on to the next generation.

High net worth individuals from abroad are mainly attracted by Austria's natural beauty and cultural richness. In the Mercer Quality of Living Ranking, Austria's capital city, Vienna, has been ranked number one for nine consecutive years and its political stability and security appeal to people from abroad. In addition, Austria has introduced a citizenship and residency by investment scheme, which further entices non-Austrians looking to relocate.

The challenge of the rather high personal income tax rates requires structuring and planning on the part of advisers. Austrian structures often include an Austrian private foundation, which in particular caters to the individual's wish for predictability and stability in relation to asset management and succession.

II TAX

i Personal income tax

General

Any individual having a permanent home or his or her habitual abode in Austria is deemed to be an Austrian tax resident. There is no concept of domicile in Austria.

Individuals have a permanent home in Austria if they have a dwelling at their disposal that they (are going to) use as a residence. The dwelling does not have to be the primary residence but it must be suitable for living considering the individual’s personal circumstances.

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1 Paul Doralt is a partner and Katharina Binder is an associate at DORDA.
2 Section 1(2) of the Austrian Income Tax Act.
3 Section 26(1) of the Austrian Federal Fiscal Procedures Act.
It does not have to be continuously used but at least recurrently to establish a permanent home for Austrian taxation purposes. Exemptions apply for individuals with vacation homes if they do not use them for more than two months per year.4

Individuals have their habitual abode or habitual residence in Austria, if they stay in Austria not only temporarily (e.g., holiday, business trip, family visit) but for a longer period of time. In any case, after a six-month stay, they become retroactively resident for Austrian income tax purposes.

Austrian-resident individuals are subject to national federal income tax. No local income taxes are levied. They are taxable on their worldwide income, whether received in cash or in kind.5 Non-resident individuals pay tax on their Austrian-source income.6

Income tax is levied on an individual’s income from seven sources:7

a agriculture and forestry;

b self-employment;

c trade and business;

d employment;


e investment;

f rent, lease payments and royalties; and

g other specified income, such as certain annuities and capital gains upon the disposal of certain privately held assets, in particular real property.

Income not covered by these categories is not taxable.

Austria generally taxes income at a progressive tax rate, ranging from 25 per cent to 50 per cent (55 per cent for income exceeding €1 million in the calendar years 2016 to 2020).8 Investment income (i.e., interest from bonds, dividends on stocks, capital gains from securities and income from derivatives) drawn in Austria is generally subject to a special flat rate tax of 27.5 per cent;9 interest from savings accounts and current accounts is taxed at a flat rate of 25 per cent. Income from a sale of private real property is subject to 30 per cent property gains tax.10

ii Cross-border structuring

Double taxation treaties

Austria has entered into about 90 income tax and capital gains tax treaties, including treaties with the UK and the US. They generally follow the Organisation for Economic Co-operation and Development (OECD) model, except for some of the older agreements, such as the ones with Brazil, France or Japan, which substantially deviate from the OECD model.

Before Austria abolished its gift and inheritance taxes in 2008, it entered into very few inheritance and gift double taxation treaties, which generally follow the OECD Model Estate and Gift Tax Treaty, among them an agreement with the US.

4 Austrian Secondary Residence Regulation.
5 Unlimited tax liability, Section 1(2) of the Austrian Income Tax Act.
6 Limited tax liability, Section 1(3) of the Austrian Income Tax Act.
7 Section 2(3) of the Austrian Income Tax Act.
8 Section 33(1) of the Austrian Income Tax Act.
9 Section 27a of the Austrian Income Tax Act.
10 Section 30a(1) of the Austrian Income Tax Act.
Pre-entry tax planning

Pre-entry income and capital gains tax planning is generally not required. Financial assets held by a newly established Austrian tax resident receive a step-up in basis to the fair market value at the time such individual becomes tax resident in Austria. Any Austrian capital gains tax payable in the event of a disposal will be based on the step-up basis. It is, therefore, advisable to keep a record of the assets' fair market value at the time of entry into Austrian tax residence.

In addition, Austria implemented a preferential tax regime for artists, scientists, and sportsmen, whose relocation to Austria is in the public interest of Austria.

Exit tax

If an individual ceases to be an Austrian tax resident, Austria taxes any increases in value of the individual’s assets accrued during such individual’s tax residency in Austria. As long as the individual moves to a country with which Austria has agreed on a comprehensive exchange of information, it may apply for a non-imposition of this tax liability until its actual disposal of the assets. If the new country of residence has no exchange of information agreement with Austria, the tax liability may be paid in even instalments over the next seven years.

iii Gift and succession taxes

Austria currently levies neither gift nor inheritance tax. There are, however, notification obligations for certain gifts if the donor or the donee has their permanent home or habitual abode in Austria.

Gratuitous transfers of real property located in Austria or transfers of, or the consolidation of, a substantial shareholding (at least 95 per cent) in a company owning real property in Austria (whether inter vivos or mortis causa) are subject to real estate transfer tax based on the property’s land value. A property’s land value being the lowest of (1) three times the value of the land as assessed under the Austrian Land Valuation Regulation plus the value of the building; (2) the property’s standardised value based on average property values published by Statistics Austria; or (3) the property’s fair market value. Austrian real estate transfer tax is levied on gratuitous transfers in tiers: the first €250,000 of land value is taxed at 0.5 per cent, the subsequent €150,000 at 2 per cent and any exceeding land value at 3.5 per cent. Special provisions apply for only partially gratuitous transfers. In addition, a 1.1 per cent fee falls due for the registration of a new owner in the Austrian land register.

11 Section 27(6)1e) of the Austrian Income Tax Act.
12 Section 27a(3)b) of the Austrian Income Tax Act.
13 Section 103 of the Austrian Income Tax Act.
14 Section 27a(3)b) of the Austrian Income Tax Act.
15 Section 27(6)1a) of the Austrian Income Tax Act.
16 Section (6)(6) of the Austrian Income Tax Act.
17 Austrian Gift Notification Act.
18 Sections 1 and 4 of the Austrian Real Estate Transfer Tax Act.
19 Section 4(1) of the Austrian Real Estate Transfer Tax Act.
20 Section 7(1)(2)a) of the Austrian Real Estate Transfer Tax Act.
21 Fee Item 9(b) of the Austrian Court Fees Act.
iv Wealth tax

Austria does not levy general wealth tax. Owners of Austrian real property are subject to property tax based on the property’s historically assessed uniform value, which is generally substantially lower than its actual fair value. The property tax is levied by the local municipality at a basic federal rate of 0.2 per cent multiplied by a municipal coefficient of up to 500 per cent.23

v Issues impacting entrepreneurs as holders of active business interests

General

In relation to interests held by Austrian or foreign individuals in Austrian enterprises, Austrian tax law differentiates between transparent and opaque business structures. Enterprises in the form of partnerships are generally regarded as transparent and Austria looks at the individual partners when it comes to assessing the applicable tax liability. By contrast, corporations are regarded as opaque and a corporation is subject to Austrian corporate income tax on its worldwide income if it has either its statutory seat or its place of effective management in Austria.24

An Austrian branch of a foreign corporation is subject to Austrian corporate income tax if it qualifies as a permanent establishment. If the individual held its business interest in Austria via a foreign corporation, that foreign corporation would thus become subject to Austrian corporate income tax with all income attributable to the permanent establishment in Austria.

Corporate income tax is levied at a rate of 25 per cent.25

Register of Beneficial Owners

Implementing the Fourth EU Anti-Money Laundering Directive, Austria also established a Register of Beneficial Owners. Austrian legal entities, including private foundations, are obliged to disclose and submit the details of their (ultimate) beneficial owners to this register and keep it updated at any time.26 The Austrian Register of Beneficial Owners is not of public record. Apart from the (tax) authorities, it is accessible by duly authorised legal, financial and tax advisers as well as the concerned entity itself.

vi Regulatory

There are no specific disclosure requirements for aggressive tax planning schemes in Austria. The Austrian Federal Fiscal Procedures Act contains a general anti-abuse provision incorporating the substance-over-form principle into Austrian tax law.27 It allows Austrian tax

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22 Section 12 of the Austrian Property Tax Act.
23 Sections 19ff of the Austrian Property Tax Act.
24 Section 1 of the Austrian Corporate Income Tax Act.
26 Sections 1 and 3(3) of the Austrian Beneficial Ownership Register Act
27 Section 22 of the Austrian Federal Fiscal Procedures Act.
authorities to disregard transactions or structures, which have been mainly implemented for the purpose of avoiding or reducing the tax burden and appear unreasonable, contrary to the goal and purpose of the tax provision concerned.\textsuperscript{28}

In addition, Austrian law provides for several more specific anti-abuse provisions, such as the 'actual place of management' test for corporate taxation, controlled foreign corporation (CFC) rules, or substance requirements in the context of the participation exemption regime.\textsuperscript{29}

III SUCCESSION

Introduction to the Austrian succession regime

Testamentary freedom and its limits

Under Austrian law, the principle of testamentary freedom applies and an individual is generally not restricted in his or her disposition over his or her estate during their lifetime. An individual's estate for succession thereby comprises all of his or her rights and obligations at the time of his or her death, whether in his or her sole name or in a co-ownership.

The most important limit to the testamentary freedom is the Austrian forced heirship regime (see below). In addition, if a married couple enters into a testamentary contract, or if an individual makes a gift on death, a quarter of the individual's estate must by law remain clear of any such dispositions as well as claims of forced heirship.\textsuperscript{30}

Forced heirship

Under the Austrian forced heirship rules, the individual's children, spouse and registered civil partner are entitled to forced heirship claims amounting to half of their statutory share in the estate.\textsuperscript{31} The forced heirship claim is generally a cash claim\textsuperscript{32} against the testamentary heirs, which is calculated on the basis of the total fair value of the deceased's assets\textsuperscript{33} and due one year after the individual's death.\textsuperscript{34} Gifts made by the individual to family members entitled to claims of forced heirship prior to his or her death are taken into account for the calculation of forced heirship claims and may also result in clawbacks of lifetime gifts.\textsuperscript{35}

Statutory inheritance rules

If an individual dies intestate, family members of the deceased individual share the estate based on a modified per capita system.\textsuperscript{36} Under these rules, the spouse or registered civil partner is entitled to one-third of the estate's value, while all of the individual's children share two-thirds of the estate's value.\textsuperscript{37} If the deceased leaves no children behind, the spouse or registered civil partner is entitled to two-thirds of the estate if the parents of the deceased

\textsuperscript{28} Section 22 of the Austrian Federal Fiscal Procedures Act as will be implemented under the Austrian Annual Tax Act 2018.

\textsuperscript{29} Sections 10 and 11 of the Austrian Corporate Income Tax Act and Section 94 of the Austrian Income Tax Act.

\textsuperscript{30} Section 1253 of the Austrian General Civil Law Code.

\textsuperscript{31} Sections 757 and 759 of the Austrian General Civil Law Code.

\textsuperscript{32} Section 763 of the Austrian General Civil Law Code.

\textsuperscript{33} Sections 778 and 779 of the Austrian General Civil Law Code.

\textsuperscript{34} Section 765(2) of the Austrian General Civil Law Code.

\textsuperscript{35} Sections 780ff of the Austrian General Civil Law Code.

\textsuperscript{36} Sections 727ff of the Austrian General Civil Law Code.

\textsuperscript{37} Section 744(1) of the Austrian General Civil Law Code.
individual are still alive.\textsuperscript{38} If one or both parents are already deceased at the time of the individual’s death, their share in the remaining third of the estate is also passed to the spouse or registered civil partner.\textsuperscript{39}

If the individual leaves neither valid instructions for the disposition of his or her estate nor statutory heirs, the estate passes to the individual’s life companion, provided that the life companion lived with the deceased in a shared household for three years prior to the deceased individual’s death.\textsuperscript{40}

Austrian law bestows the same statutory inheritance rights on illegitimate and adoptive children to their adoptive parents’ estates as on natural legitimate children.\textsuperscript{41} In addition, adoptive children keep their statutory inheritance rights to the estates of their natural parents.\textsuperscript{42} Adoptive children, however, have no statutory inheritance rights to the estate of other members of their adoptive family.

**Formal requirements of a last will and testament**

Under Austrian law, an individual may make a valid will either in writing, orally or publicly.\textsuperscript{43}

A valid will in writing can either be entirely handwritten and signed\textsuperscript{44} or a printed document, where he or she, in front of three independent and simultaneously present witnesses, adds a handwritten solemn declaration that the document contains his or her last will and testament.\textsuperscript{45} The witnesses must then also add their handwritten signatures indicating their personal details and position as witnesses.\textsuperscript{46} Outside the court, an oral will can be validly made only in life-threatening situations. It requires two independent witnesses and is valid for three months.\textsuperscript{47} A public will is validly made in front of the court or an Austrian public notary. Individuals between 14 and 18 years of age may only make public wills.\textsuperscript{48}

**Administration of the estate and transfer to the heirs**

Under Austrian law, all heirs generally administer the estate jointly.\textsuperscript{49} It is possible to appoint a special administrator or executor for the estate, usually either based on the testator’s will or a respective joint application of the heirs.

The deceased’s assets generally pass to the heirs and successors by universal succession and to the legatees by singular succession based on a respective decree issued by the probate court after the probate proceeding has been completed. An heir may accept his or her share in the estate either unconditionally, assuming liability for the deceased’s debts regardless of

\begin{itemize}
\item \textsuperscript{38} Section 744(1) of the Austrian General Civil Law Code.
\item \textsuperscript{39} Section 744(1) of the Austrian General Civil Law Code.
\item \textsuperscript{40} Section 748(1) of the Austrian General Civil Law Code.
\item \textsuperscript{41} Section 197 of the Austrian General Civil Law Code.
\item \textsuperscript{42} Section 199 of the Austrian General Civil Law Code.
\item \textsuperscript{43} Section 577 of the Austrian General Civil Law Code.
\item \textsuperscript{44} Section 578 of the Austrian General Civil Law Code.
\item \textsuperscript{45} Section 579(1) of the Austrian General Civil Law Code.
\item \textsuperscript{46} Section 579(2) of the Austrian General Civil Law Code.
\item \textsuperscript{47} Section 584 of the Austrian General Civil Law Code.
\item \textsuperscript{48} Section 569 of the Austrian General Civil Law Code.
\item \textsuperscript{49} Section 810(1) of the Austrian General Civil Law Code.
\end{itemize}
the value of his or her inherited share in the estate, or conditionally, assuming liability for the deceased’s debts only up to the value of his or her inherited share in the estate based on an appraisal and inventory.

ii Cross-border scenarios

EU Succession Regulation

Austria implemented the EU Succession Regulation, under which the distribution of a person’s estate is generally governed by the law of the country, where the deceased had his or her last habitual abode, regardless of whether it is an EU country or not. An individual may also validly opt for the application of the inheritance regime of his or her nationality in his or her last will. The respectively applicable law governs the distribution of movable and immovable property.

Recognition of wills

In relation to wills, Austria adopted the Hague Testamentary Dispositions Convention on the Conflicts of Law Relating to the Form of Testamentary Dispositions 1961 (the HCCH Convention). Under its rules, a will is valid and thus recognised in Austria if its form complies with the internal law of:

a the place where the testator made it;
b a nationality possessed by the testator, either at the time when he or she made the disposition, or at the time of his or her death;
c a place in which the testator had his or her permanent home either at the time when he or she made the disposition, or at the time of his or her death; or
d so far as immovables are concerned, the place where they are situated.

IV WEALTH STRUCTURING AND REGULATION

i Wealth structuring vehicles used in Austria

Austrian private foundation

The most commonly used vehicle for wealth structuring in Austria is the private foundation, a legal entity designed as managed property without an owner or a shareholder. It may be set up for charitable purposes or private purposes but it may not pursue commercial activities. The founders can be individuals or legal entities; the minimum capital is €70,000. It is possible for the founder to be a beneficiary. A management board, consisting of at least three members, two of whom must have their habitual abode in the EEA, is the governing...
body of the private foundation.57 Neither beneficiaries nor their close family members or personal advisers may be part of the managing board.58 The private foundation’s annual accounts are not publicly disclosed but must be audited by a CPA.59

A recent bill amending the Austrian Private Foundation Act introduced, *inter alia*, the possibility of a single member management board if the private foundation has installed a supervisory body of at least three members (2017 Private Foundation Bill). This Bill was set to enter into force by 1 November 2017 but it is still unclear when, and in what final form, the proposal will be enacted by the government.60

**Trusts**

There are no trusts under Austrian law. Austria has neither ratified the HCCH Convention or the Law Applicable to Trusts and on their Recognition (the Hague Trust Convention).

### ii Legal and tax treatment

#### Taxation of an Austrian private foundation

Austria recognises private foundations as separate legal entities. Gratuitous contributions to Austrian private foundations and comparable foreign entities are subject to 2.5 per cent foundation contribution tax on the fair market value of the assets contributed.61 If not all required information is disclosed to the tax authorities or certain other conditions are not met, the tax rate is increased to 25 per cent.62 Contributions of Austrian real property are subject to real estate transfer tax (see above) plus a 2.5 per cent foundation contribution tax equivalent and land register fees of 1.1 per cent based on the property’s land value.63

In relation to their income, Austrian private foundations are treated like corporations under the Austrian Corporate Income Tax Act and, therefore, subject to the common corporate income tax rate of 25 per cent on their worldwide income; dividends received by a private foundation are, however, usually tax-exempt.64 A withholding tax of 27.5 per cent is generally levied on distributions to beneficiaries,65 but double tax treaties typically grant relief if the beneficiary is a non-Austrian tax resident.

As long as the private foundation complies with all applicable disclosure requirements concerning the Austrian tax authorities (i.e., beneficial ownership, statutes), Austria grants a relief from double taxation otherwise levied on the foundation’s non-business income. To this end, Austria levies a 25 per cent ‘interim tax’ on the private foundation’s investment income (interest and capital gains from securities) and income derived from the disposal of real property on a taxable basis effectively reduced by the amount distributed to the beneficiaries.

57 Section 15(1) of the Austrian Private Foundation Act.
58 Section 15(2), (3) and (3a) of the Austrian Private Foundation Act.
59 Section 20 of the Austrian Private Foundation Act.
60 The current status of the bill can be monitored at https://www.parlament.gv.at/PAKT/VHG/XXV/ME/ME_00323/index.shtml#tab-Ubersicht.
61 Section 2 in connection with Section 1(5) of the Austrian Foundation Entry Tax Act.
62 Section 2 of the Austrian Foundation Contribution Tax Act.
63 Section 7(2) of the Real Estate Transfer Tax Act and Fee Item 9(b) of the Austrian Court Fees Act.
64 Sections. 1, 10 and 22 of the Austrian Corporate Income Tax Act.
65 Section 27(5)(7) of the Austrian Income Tax Act.
in that tax year. In addition, a rollover relief is granted for capital gains from the disposal of substantial participations if the private foundation acquires other substantial participations within 12 months.

**Taxation of trusts**

Depending on their individual set-up, foreign trusts and comparable vehicles are taxed in Austria based on their qualification as either a transparent or opaque entity. To determine the applicable regime, the Austrian tax authorities look in particular to the settlor's and the beneficiary's controlling influence and rights in the trust and its assets.

iii **Advantages of an Austrian private foundation**

Austrian private foundations are primarily established for purposes of succession planning, in particular if the founder's assets shall not be broken up between his or her heirs. This is especially of interest to a founder who is the owner of an active enterprise, which, in future, could be controlled by the private foundation as a common representative of the next generation. As the beneficiaries of the private foundation, the heirs would commonly form an advisory board that may guide the management board in its executive decisions.

In addition and on a more general note, a private foundation's beneficiaries are not on public record and the private foundation's financial statements remain undisclosed to the public. The private foundation, therefore, grants the most possible privacy to the founder and the beneficiaries while still being a viable asset-pooling and holding vehicle. These aspects will be further supplemented by the possibility of a sleeker management board as proposed by the 2017 Private Foundation Bill.

**V OUTLOOK AND CONCLUSIONS**

Austria is a wealthy and politically stable jurisdiction that will continue to appeal to people of sizeable wealth.

In the near future, it will implement the next steps proposed by the EU under the Anti-Tax Avoidance Directive and Base Erosion and Profit Shifting, and will introduce a CFC provision to the Austrian Corporate Income Tax Act applicable for financial years starting on or after 1 October 2018. This measure will also affect corporate holding structures held by private foundations and high net worth individuals, and, therefore, lead to a re-evaluation of current arrangements.

The upcoming months will also show how and when the recently elected conservative government will follow through with their announcement to introduce a more business-friendly tax regime, which should also attract inward investment more strongly.

67 Section 13(4)(4) of the Austrian Corporate Income Tax Act.
68 Austrian Supreme Administrative Court, 20 September 1988, 87/14/167; EAS 2378, EAS 2804.
69 An Austrian private foundation's beneficiaries must only be disclosed to the tax authorities and in the non-public Austrian Register of Beneficial Owners (Section 2(3) of the Austrian Beneficial Ownership Register Act).
Chapter 8

BAHAMAS

John F Wilson

I INTRODUCTION

It is not by chance that the Bahamas has, over numerous decades, distinguished itself as a leading international financial centre. Much thought, effort and focused attention have gone into producing the ideal environment in order to position the Bahamas as the pre-eminent offshore tax-neutral jurisdiction with the physical resources and legislative framework necessary to attract the business of the ultra-high net worth individuals and families. In addition, its progressive residency regime and available physical resources make it possible for the ultra-high net worth and high net worth individuals to follow their wealth and to live where they bank. With its close proximity to the US, and established links and direct air lifts to North American, European and Latin American markets, the Bahamas’ geographic advantage is unequalled by its competitors.

The Bahamas’ mature and sophisticated financial services industry is home to a number of the world’s largest wealth providers but there are also a number of well-capitalised and financially strong boutique institutions available for those who prefer a more personalised relationship. The industry is serviced by a well-trained cadre of professionals, from private bankers to lawyers and accountants, and there is no shortage of available professional talent. Further, with the increasing move towards liberalisation of the Bahamas’ immigration regime, the ability to import the necessary talent to service the needs of the ultra-high net worth and high net worth individuals is becoming increasingly easy.

The key points that make the Bahamas an important jurisdiction for private client matters are:

a Location: the Bahamas is situated a few miles off the coast of the United States, making it a hub for regional investment and business in the United States, Canada and Central and South America.

b Political and economic stability: the Bahamas has more than 280 years of uninterrupted parliamentary democracy. The Bahamas ushered in a new government in May 2017 following a highly anticipated general election, but that has not affected its stance as the mecca in the financial services industry. Additionally, its currency is on a par with the US dollar.

c Wealth- and asset-management services: the Bahamas offers a significant number of financial institutions, delivering services including banking, private banking and trust

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1 John F Wilson is a partner at McKinney Bancroft & Hughes.
services, accounting and legal services, e-commerce, insurance, and corporate and shipping registries. Additionally, there is in excess of 700 funds that are licensed in the Bahamas, with assets under management totalling over B$200 billion.

**Infrastructure:** The Bahamas has the infrastructure in place that allows for international business, with some 21 international airports, 10,000 acres on Grand Bahama Island earmarked for an industrial and commercial free zone area, one of the deepest harbours in the region and modern facilities connected globally via fibre-optic cable. Additionally, there are world-famous residential communities such as Albany, Lyford Cay and Old Fort Bay, which allow the high and ultra-high net worth families to live, work and play where their wealth is both maintained and preserved.

**Highly educated workforce:** Most Bahamian wealth management practitioners attain their degrees from universities in the United States, Canada and the United Kingdom.

**Taxation:** The Bahamas remains a tax-neutral platform where international persons receive the same tax benefits as Bahamians. There are no income, capital gains and inheritance taxes for all residents of the Bahamas.

**Regulation:** The Bahamas adheres to all international regulatory principles and is also active in multilateral organisations established to set and monitor standards for regulation and anti-money laundering and countering of terrorist financing (AML/CFT). In this way all of its institutions continue to have access to the international banking and investment markets.

**Permanent residency:** The Bahamas has a liberal policy for granting economic permanent residency. The minimum residential investment threshold for application for permanent residency is B$500,000; for accelerated consideration an investment of B$1.5 million or greater enables the application to be considered within 21 days.

### II TAX

What differentiates the Bahamas from most jurisdictions is that it remains a tax-neutral platform, where international persons receive the same tax benefits as Bahamians. This includes:

- **No income, capital gains and inheritance taxes** for all who conduct business or reside in the Bahamas;
- **A modest business licence tax** for companies carrying on business in the Bahamas;
- **A 2.5 per cent government stamp tax** and a 12 per cent value added tax on the purchase of a new home;
- **Real property taxes** of 1.5 per cent of the property value;
- **A modest monthly national insurance payment** for employees;
- **A 12 per cent value added tax** on most forms of consumer spending – both goods and services;
- **Companies**, meanwhile, operate **tax-free** within the free trade zone of Freeport on Grand Bahama Island, under the terms of the 99-year Hawksbill Creek Agreement, signed by the government in 1955;
- **Developments relating to personal taxation** for individuals both in relation to gift and succession taxes; and

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there are no gift and succession taxes in the Bahamas.

**Issues relating to cross-border structuring**

The Bahamas Trust (Choice of Governing Law) Act 1989 makes it permissible for a trust administered anywhere in the world to designate Bahamian law as the governing law. In addition, the Bahamas has very facilitative rules allowing for corporate entities to be continued into and from the Bahamas.

A key component of the Bahamas’ wealth management regime is its adherence to the principle that persons have a right to confidentiality with respect to the conduct of banking affairs. This right has been codified under the Banks and Trust Companies Regulations Act 2000. In relation to requests for information from foreign regulatory bodies the Bahamas will share information only on agreed and transparent protocols agreed to under a tax information exchange agreement (TIEA) reflecting the Organisation for Economic Co-operation and Development (OECD) standard for tax information exchange.

**Regulatory issues relevant to high net worth individuals generally or that impact the general market of private wealth services**

In compliance with the OECD standard for tax cooperation between countries, the Bahamas has committed to international standards of international tax cooperation by signing TIEAs with 30 countries to date.

All of the agreements signed by the Bahamas are in accordance with the OECD model TIEA. Accordingly, the Bahamas will only cooperate with countries in the same manner as all countries that adopt Article 26. In particular, through agreements, the Bahamas commits to cooperating only upon requests where specific information is provided. This requirement for specific information is critical in furtherance of the Bahamas’ stated position of trying to prevent ‘fishing expeditions’.

The Bahamas has also now entered into an intergovernmental agreement with the United States, signalling its compliance with the United States Foreign Accounts Tax Compliance Act (FATCA). FATCA imposes automatic reporting requirements on all foreign financial institutions relating to their dealings with US persons. The implementation of reporting requirements under FATCA presented certain challenges under Bahamian law as it had to be reconciled with the duty of confidentiality as outlined under Section 19 of the Banks & Trusts Companies Regulation Act 2000 (BTCRA), the Data Protection Act 2003 and the Bahamian Common Law. In many instances, financial institutions have reconciled this conundrum by having their clients provide written waivers of the rights under Bahamian confidentiality and privacy laws that would allow foreign financial institutions to report relevant information to the United States tax authorities.

The Bahamas has also joined the growing list of countries that have agreed the OECD’s Common Reporting Standard (CRS) for the automatic exchange of information, which the Bahamas agreed to implement in 2017. Following this, the Bahamas enacted the Automatic Exchange of Financial Account Information Act on 29 December 2016 to give effect to the CRS and confer the necessary powers on the competent authority to enter into an agreement.

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3 Section 4.
4 Section 84 of the International Business Companies Act.
with the government of another country for the automatic exchange of financial account information in tax matters. Under the former government of the Bahamas, the Bahamas was to take a bilateral approach to its CRS obligation. However, the new government has taken a different track and has indicated its intention to implement CRS by way of the Multilateral Convention on the Mutual Administrative Assistance in Tax Matters on a non-reciprocal basis.

Accordingly, with this wider approach, all financial institutions operating in the Bahamas are now required to collect and retain CRS information and be ready to report it for all account holders and transmit same once notified to do so by the competent authority.

The Bahamas remains strongly committed to the principle that persons have a right to confidentiality and privacy\(^6\) in relation to the conduct of their affairs. This right is an essential cog in Bahamian jurisprudence. Moreover, respect for the rule of law is a fundamental element to the success and strength of the Bahamas as a jurisdiction. Consequently, the ultra-high and high net worth individuals can be assured that the Bahamas will only exchange information on agreed and transparent protocols.\(^7\)

The BTCRA\(^8\) allows foreign banking regulators that regulate a bank or trust company with a branch or subsidiary incorporated in the Bahamas, to conduct an inspection, under conditions of confidentiality, solely for the purposes of consolidated supervision, of the books and accounts of any branch or subsidiary of that bank and trust company in the Bahamas. However, it should be noted that the BTCRA provides individual customers with a degree of confidentiality, with limited exceptions, with regard to their assets under management of a bank and trust company in the Bahamas. The following are examples of exceptions of a bank and trust company’s duty to maintain confidentiality of banking information:\(^9\)

\(a\) to assist the Central Bank Governor in functions conferred by Bahamian law; and

\(b\) for the institution of, or for the purpose of:

\(\cdot\) criminal proceedings; or

\(\cdot\) disciplinary proceedings in the Bahamas or abroad relating to a lawyer, auditor, accountant, valuer or actuary, public officer or employee of the Central Bank.

### III \hspace{0.1em} \textbf{SUCCESION}

A key factor for wealth preservation in the Bahamas is that there is no inheritance tax within the jurisdiction.

The Bahamas is a common law jurisdiction and its probate and administration of estates legislation is based mainly on the laws of England and Wales. Under the Probate and Administration of Estates Act 2011,\(^10\) the Supreme Court of the Bahamas has jurisdiction to make a grant of representation in respect of a deceased person who was ordinarily resident in the Bahamas, or whose estate consists of property in the Bahamas.

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\(^6\) The Data Protection (Privacy of Personal Information) Act 2003 provides for the protection of privacy of individuals with regard to personal data.

\(^7\) Ibid.


\(^9\) Ibid.

Relevant cross-border developments

The court will issue a resealed grant in respect of any grant of probate or other testamentary disposition issued by any member state of the Commonwealth; any state of the United States; or in any other country specified by order by the Attorney General provided that the requisite certified and duly authenticated copies of such foreign grant, etc., are produced to support the application.\(^\text{11}\)

Notwithstanding that the Bahamas is a common law jurisdiction, the law adequately provides for administration of estates emanating from civil law jurisdictions, such as the European countries (e.g., Switzerland, Germany, France), the South American countries (e.g., Argentina, Brazil, Chile) and other territories, such as the Dutch Antilles and Quebec.\(^\text{12}\)

The court will also issue a grant of letters of administration with the will annexed where a deceased testator owns Bahamian assets but for some specific reason it was not necessary to apply for a grant in respect of his or her will in his or her place of domicile.

Where a person dies intestate in a common law jurisdiction, the court will issue a grant of letters of administration in respect of his or her estate in the first instance to the surviving spouse or to such other person approved by the court and by which grant the administrator is vested with powers and duties similar to those of an executor.\(^\text{13}\)

Applicable changes affecting personal property

Developments on prenuptial agreements in the Bahamas

Traditionally Bahamian courts did not give effect to prenuptial agreements. In more recent times, however, the courts have taken the view that the terms of a prenuptial agreement are a factor to take into account when exercising the court’s discretion under the Matrimonial Causes Act 1879.

In *M v. F*,\(^\text{14}\) a decision delivered on 7 June 2011 by the Supreme Court of the Bahamas, following the law in the United Kingdom, held that under Bahamian law a prenuptial agreement was merely persuasive and not binding on the distribution of marital assets upon the breakdown of a marriage. The Court held that to give effect or determination to prenuptial agreements the Court must be satisfied that the agreement was entered into freely and voluntarily by both parties with full appreciation of its implication and if it was, whether it would be unfair to give effect to the agreement.

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\(^{11}\) Ibid.
\(^{12}\) Ibid.
\(^{13}\) Ibid.
IV WEALTH STRUCTURING AND REGULATION

i Commonly used vehicles for wealth structuring, such as trusts, foundations or partnerships

The International Business Companies Act 2000

An international business company (IBC) may be used to establish a private trust company (PTC) or a family office, or to create an investment fund. The IBC is the basic building block used in the Bahamas to create structures to preserve and accumulate wealth; as such, it is an indispensable tool for estate planning.\(^{15}\)

An IBC is incorporated under the International Business Companies Act 2000 by two or more persons subscribing to a memorandum that satisfies the requirements of the Act, and may be established for a limited duration. The memorandum and articles must be registered with the Registrar of Companies who will issue a certificate of incorporation certifying that the IBC is incorporated. An IBC can usually be incorporated within a day or two. There is no requirement that a national of the Bahamas be a participant, manager or director of the IBC and there are no restrictions on capitalisation. An IBC may have only one director, and it must maintain a registered office in the Bahamas.

There are no tax consequences for utilising an IBC if the IBC does no business in this jurisdiction. Further, an IBC and its shareholders are not subject to any income tax, corporate tax, business licence fees or stamp duty on transactions concerning an IBC, except that stamp duty is payable in relation to real property situated in the Bahamas that it owns, or is owned by any company in which it holds shares or for which it holds a lease.\(^{16}\) This statutory relief from taxation is valid for 20 years from date of incorporation.\(^{17}\) The applicable fees and taxes for IBCs are:

- a) government fees for incorporation: B$330 upon filing the memorandum and articles of association; and
- b) on 1 January each year, the IBC must pay an annual fee of either B$350 depending on whether the authorised capital is B$50,000 or less, or B$1,000 if the authorised capital is B$50,0001 or more.

ii Trusts

Trusts are recognised in the Bahamas and are governed by the Trustee Act 1998. The trust under Bahamian law is a relationship whereby one party (settlor) transfers assets to another (trustee) to be held for the benefit of a third party (beneficiary). Assets transferred to a trustee under trust cease to be legally owned by the transferor and become subject to the terms of the trust.

There is no legal requirement for trusts to be registered or for public disclosures to be made. Exchange control regulations do not apply to non-resident settlors, donors, beneficiaries and trustees participating in an offshore trust. An exemption exists in respect of trusts with non-resident beneficiaries, in connection with the payment of taxes, including stamp duty on transfers of property into trusts.

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15 Above, footnote No. 2.
17 Ibid.
Other features of a Bahamian trust include the ability of a settlor to retain a wide range of powers without the trust being declared a sham. Subject to the terms of the trust, trustees have wide statutory investment and management powers, and a protector may be appointed to oversee the trust. The Trusts (Choice of Governing Law) Act 1998 provides protection against forced heirship laws.

iii Asset protection trusts (APTs)
The operation of asset protection trusts in the Bahamas is supported by the provisions of the Fraudulent Dispositions Act 1991.18 The Act protects the assets of a settlor by placing them out of the reach of creditors who commence litigation in relation to those assets more than two years after the assets were transferred into the trust. Under the Fraudulent Dispositions Act forced heirship laws are not recognised.

iv Purpose trusts
Persons investing in the Bahamas may use a purpose trust as a component of their investment scheme. A purpose trust can be created for purposes that are not charitable and will not require an individual or corporate beneficiary. The intent behind a purpose trust must be possible and sufficiently certain to allow the trust to be carried out, and not be contrary to public policy or unlawful. Purpose trusts can be fixed or discretionary and unless otherwise expressed in the trust instrument, the trustee may distribute capital and income between different authorised purposes, individuals, corporations and charitable purposes. With the exception of land, and any interest in land, almost any assets can be the subject of a purpose trust.

v PTC
A PTC is a company incorporated under the Companies Act or the International Business Companies Act that acts as trustee only for a trust or trusts created or to be created by or at the direction of a designated person or persons or an individual or individuals who are related to the designated person described within the designating instrument. The establishment of the PTC allows for the trusteeship of a defined class of trusts by reference to the designated person. All other settlors of trusts for whom the PTC acts as trustee must be related to the designated person or persons.

vi Foundations
As an alternative to trusts and corporations, wealth management planners may employ the use of a Bahamian foundation. This distinctly European concept was introduced into Bahamian law by the Foundations Act 2004.19 The foundation is best understood as a hybrid between a trust and a company. The foundation will have beneficiaries and may have a protector. It can be established by a will and no forced heirship rules apply. It may be revoked by the founder if provided for in the charter by which it is established. Upon registration, the foundation will be a legal entity, resident and domiciled in the Bahamas with the capacity to sue and be sued in its own name. It may enjoy unlimited duration, subject to the revocation of the

charter, winding up, liquidation or being otherwise terminated. The assets transferred to the foundation will become exclusively its assets and shall cease to be the assets of the person who made the endowment. The foundation documents will identify its beneficiaries, which may be individuals, a charity or the public at large. The foundation assets will not become the assets of a beneficiary unless and until distributed in accordance with the provisions of the foundation charter, the articles (if any) and the Foundations Act. The foundation must have assets valued at not less than US$10,000 or the equivalent thereof in another currency.

The foundation will have a stated purpose or object that may be any lawful purpose and may, but need not, be charitable. The Foundations Act describes the main purposes or objects of a foundation, including the management of its assets. This may involve the buying and selling of such assets.

vii  General partnership

There is no requirement that a national of the Bahamas or a related state be a partner in a general partnership arrangement. Fees for establishing a general partnership relationship will vary depending on the complexity of the arrangement and will usually be restricted to fees for professional services rendered in connection with advising generally on the partnership and for preparation of documents. A partner in a general partnership will potentially be personally liable for debts contracted on behalf of the firm although as between partners his or her liability may be limited to the proportionate value of his or her share in the partnership. Value added tax of 7.5 per cent is payable on goods and services provided by the partnership where the annual taxable sales of the partnership’s business exceeds B$100,000.

viii  Applicable anti-money laundering regime and other key aspects of regulation of service providers dealing with private wealth

Over the years, the Bahamas has developed an extensive regulatory regime for private wealth service providers, in order to comply with 21st century international standards, and to maintain its reputation as a reputable international financial centre.

The Bahamas operates in a globally integrated market for financial services. As a result the country’s counter-money laundering legislation meets global best practices and standards.20

The Bahamas is a member of the Caribbean Financial Action Task Force (CFATF), a FATF-style regional body composed of 30 member states from the Caribbean Basin. The CFATF conducts peer reviews of its members’ AML and CFT laws, policies and procedures and assesses the extent to which countries comply with the Financial Action Task Force’s 40+9 Recommendations for preventing money laundering and countering the financing of terrorism. The jurisdiction’s efforts to assess and strengthen its AML/CFT framework are ongoing.21

ix  Regulation of private wealth management service providers

The Central Bank of the Bahamas

With more than 270 banks and trust companies operating in the Bahamas, and the banking industry itself the cornerstone of the country’s financial services industry, the Central Bank

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21 Ibid.
plays a lead role among the country’s regulatory agencies and enjoys full autonomy. Its stature within the Bahamas is reinforced by its long-standing presence in the jurisdiction; the Bahamas, in fact, has been regulating banks and trust companies since 1965.

The Central Bank fills the traditional roles as issuer of legal tender, banker to both domestic banks and the government, and regulator and supervisor of the banking sector. As supervisor of banks, the Central Bank promotes the soundness of banks and trust companies through the effective application of international regulatory and supervisory standards. It is a member of various regional and international agencies, including the Association of Banks of the Americas; Offshore Group of Banking Supervisors (OGBS); Caribbean Group of Banking Supervisor; and also serves on the Financial Expert (Mutual Evaluations) Committee of the CFATF. The OGBS has worked closely with the Basel Committee on the supervision of cross-border banking, as well as with the FATF on anti-money laundering initiatives.

Continued vigilance is required to secure an effective regulatory environment. Legislative initiatives have been designed to provide products relevant to the international market place, to enhance the regulatory oversight and supervision of the financial service sector, and to further its counter-money laundering regime. These initiatives include a focus on risk management and continually updated AML and CTF guidelines following the publication of revised FATF 40+9 Recommendations. In all, the Central Bank’s overall policy objective is the promotion of a stable economic environment conducive to high levels of domestic production, employment and growth.

The Securities Commission of the Bahamas

The Securities Commission (SCB) was established in 1995. As part of its endeavour to keep abreast of an ever-changing global regulatory environment, and to ensure a Bahamian contribution towards improving the efficiency and conduct of international markets, the SCB is a member of the International Organization of Securities Commissions – signatory A status under its multilateral memorandum of understanding – and the Council of Securities Regulators. The SCB’s mission is to effectively oversee and regulate the activities of the securities and capital markets, and to protect investors, while strengthening public and institutional confidence in the integrity of those markets.

The principal areas of focus are the securities industry, including the oversight of broker dealing and securities investment advisory services, and investment fund management and administration.

Insurance Commission of the Bahamas

The Insurance Commission of the Bahamas (ICB) is responsible for the prudential regulation of all insurance activity in or through the Bahamas. It is concerned with the ongoing monitoring and control of insurers, agents, brokers, salespeople, underwriting managers and external insurers.

Its mandate is to undertake all of the due diligence necessary to guarantee that companies that come to the Bahamas are reputable, high-quality businesses and its supervisory regime is also geared to ensure that it safeguards the interests of the policyholders involved. The ICB has developed a risk-based supervisory methodology, and a principles-based approach that allows flexibility.

The Bahamas is a member of the International Association of Insurance Supervisors, which is recognised as the standard-setting body for insurance regulators. It is also a member
of the Group of Offshore Insurance Supervisors and a member of the Caribbean Association of Insurance Supervisors. Organisations such as these instil a consistent and frequent exchange of regulatory information that helps the regulator to craft and hone world-class legislation.

V  OUTLOOK AND CONCLUSIONS

Like many other offshore jurisdictions, the Bahamas has had to rethink its approach to the development of its international financial services industry. Given the evolution in the financial services industry globally over the past decade, the Bahamas has moved from being a tax-free to a tax-neutral jurisdiction and some have advocated that the Bahamas migrates to a low-tax fully transparent jurisdiction. Initiatives such as these will continue to aid the Bahamas in distancing itself from the perception that has dogged international financial centres of being the jurisdictions of tax cheats and providing a means for hiding wealth. Through its accession to the TIEA regime and compliance with FATCA and adherence to the CRS, while continuing to hold fast to the universal right of privacy of the individual, the Bahamas continues to demonstrate that it is a well-regulated, respected and mature jurisdiction.
I INTRODUCTION

As Belgium is a federal state, taxation of individuals in Belgium depends partly on the region where the individual lives (i.e., where he or she has his or her principal place of residence). Belgium is a federal state and consists of three regions: the Brussels Capital Region, the Flemish Region and the Walloon Region. The main tax laws were originally conceived at the national level.

Following subsequent state reforms, aspects of gift and inheritance tax (including applicable rates and exemptions) and, more recently, aspects of personal income tax, have been regionalised. Consequently, the taxation of individuals is diverging from one region to another and it is expected that this evolution will continue, although the basic rules remain controlled by the national government.

Matters such as property law, gifts and succession law are national law and based on Civil Code principles. Hence, contractual freedom is the basic principle in these areas of the law.

Belgium has not enacted legislation aimed specifically at attracting foreign wealthy individuals. Specific tax incentives are focusing on companies, especially in the science and technology sectors.

Foreign wealthy individuals who choose to become Belgian residents, and thus administer their worldwide businesses and assets from Belgium, benefit from the same rights and obligations as Belgian nationals. As Belgian residents for tax purposes, they have access to the extensive network of treaties for the avoidance of double taxation that Belgium has with other jurisdictions across the globe.

In these turbulent times, the consensus remains so far uncontested that Belgium must continue to put itself in line with good legal and tax practices applicable in other jurisdictions within the European Economic Area and its internal market.

To illustrate what the jurisdiction has to offer to private individuals, Belgium does not apply its capital gains tax regime to private individuals obtaining capital gains within the scope of the normal administration of private assets. The scope of ‘normal administration’ is quite large and applies, in principle, notwithstanding the importance of the capital gain involved. It must be noted, however, that this ‘normal administration’ principle is under increasing pressure, following some recent share deals that were widely reported in the national press. It seems rather unlikely, however, that the principle will be overturned in the short term.

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1 Ferenc Ballegeer is a Belgian lawyer and the founder of FB-Private Wealth Law. He is also counsel at Brucher, Thielgen & Partners in Luxembourg.
2 Article 11 Civil Code.
A second example is that a gift of movable assets does not have to be subject to gift tax. Belgian gift tax is a stamp duty: there is no obligation to register a gift of movable assets. Depending on the region where the donor resides, inheritance tax is due on unregistered gifts from the three or seven years preceding the donor’s decease.

It must be noted that within the scope of this contribution, only the basic principles of existing legislation and new developments can be mentioned. The terminology used herein refers to the terminology of Belgian law.

II TAX

i Personal income tax

Private individuals who are Belgian residents for tax purposes are subject to personal income tax on the basis of their worldwide income, notwithstanding their nationality. Non-residents may be subject to Belgian income tax on their Belgian source income (non-resident income tax).

Personal income tax involves income from real estate, income from movable assets, professional income and a residuary category. In the latter category, there is no catch-all approach, since income within the scope of the normal administration of private assets is not taxable.

Income tax rates are progressive, and even relatively moderate income is subject to high rates.\(^3\) The first €7,730 is exempt from personal income tax. The basic tariff scheme is as follows:

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\begin{align*}
\text{a} & \quad 25 \text{ per cent from } €0.01 \text{ to } €12,990; \\
\text{b} & \quad 40 \text{ per cent from above } €12,990 \text{ to } €22,290; \\
\text{c} & \quad 45 \text{ per cent from above } €22,290 \text{ to } €39,660; \text{ and} \\
\text{d} & \quad 50 \text{ per cent from above } €39,660.
\end{align*}
\]

Interest and dividend income are taxed at a flat rate, which has been increased several times and significantly over recent years. On 1 January 2018, the 30 per cent rate in personal income tax was abolished.

What differentiates Belgium is, first of all, its capital gains tax regime. Capital gains within the residuary category of taxable income, arising from whatever speculation or operation, are taxable, except for capital gains arising within the scope of the normal administration of the private assets of the taxpayer. These principles apply also to capital gains on shares, which is of particular interest for private individuals as the notion of ‘normal administration’ has quite a large scope. Consequently, capital gains on share or asset deals may be tax-exempt.

A specific tax regime applies to capital gains on shares in a Belgian corporate legal person (i.e., legal persons that are companies) that are transferred to a legal person outside the European Economic Area if, and to the extent that, the taxpayer holds (or held) directly or indirectly 25 per cent in the Belgian corporate legal person. The applicable basic rate is 16.5 per cent, even if the operation would be within the scope of the ‘normal administration’ test.

Taxable capital gains (i.e., capital gains outside the scope of the exception and specific rule) are taxed at a basic rate of 33 per cent.

\(^3\) The amounts in euros are applicable to taxable income from the year 2018.
In the past, the advantageous Belgian capital gains tax regime was the basis of merely internal (intercompany) operations aimed at withdrawing cash or assets from a corporate legal person without paying dividend tax (now 30 per cent). Such operations included selling or exchanging shares to or with an internal holding company. Anti-abuse rules and more restrictive ruling practices in recent years have aimed to curb these operations. Since 1 January 2017, a new specific anti-avoidance rule has been put in place to further restricting such operations tackling, in particular, exchange operations.

It is also noteworthy to mention the Belgian expat tax regime. Qualifying expats are, sometimes fictitiously, considered as non-resident taxpayers for income tax purposes. They are taxable in Belgium on their Belgian source income only. The additional relocation costs paid by their employer are not considered to be part of their taxable salary (professional income). As for the company employing the expat, these relocation costs are tax-deductible in its corporate income tax.

‘Look through’ tax
In 2012, Belgium strengthened its general anti-abuse rule significantly to arrangements in breach of the purpose of a tax rule or a tax benefit.

Following international developments, notably the series of ‘leaks’ in recent years, Belgium enacted a legal obligation, initially for private individuals, to declare the existence of trusts and similar legal arrangements (first category) as well as foreign legal persons (i.e., having legal personality distinct from its shareholder or settlor – second category) of which they are settlor or third-party beneficiary in their yearly tax return. As far as the latter are concerned, this involved mainly legal persons from outside the European Economic Area, not subject to tax at all or subject to a low tax rate. At the end of 2017, a third category was added: contractual arrangements set up to invest in first or second category arrangements such as insurance contracts.

These new rules involve a self-assessment exercise for Belgian residents: first, they need to assess whether the trust-like legal arrangements, foreign legal persons or targeted contractual arrangements, of which they are settlor or third-party beneficiary, must be declared.

Since 2016, legal persons subject to the legal persons income tax, such as foundations (see below), may also be subject to this duty to declare arrangements of which they are settlor or third-party beneficiaries.

The second part of the self-assessment exercise is the new ‘look through’ tax, introduced in 2016 for private individuals subject to personal income tax and legal persons subject to legal persons income tax: a duty to declare the revenue of the legal arrangement or legal person of which they are settlor. This revenue is now taxable income of the private individual or legal person directly insofar as the taxpayer cannot prove that a third-party beneficiary within the European Economic Area received or is entitled to the revenue.

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4 The tax duties imposed on settlers and third-party beneficiaries of legal arrangements or legal persons are often referred to as ‘Cayman tax’.
5 EEA: EU Member States, Iceland, Norway and Liechtenstein. So far only three EEA legal persons are within the scope of this Belgian legislation: the Liechtenstein ‘Stiftung’, the Liechtenstein ‘Anstalt’ and the Luxemburg ‘Société de Gestion de Patrimoine Familial’.
6 Settlor and third-party beneficiary are defined by the Belgian Income Tax Code. The notions differ from what may be understood by it in other jurisdictions.
In response to a parliamentary question, the finance minister answered that the look-through tax also applies to ‘double structures’ (i.e., legal entities constituted by legal arrangements or legal persons). The reasoning is that it would be unacceptable avoiding its application by setting up ‘double structures’. This position was shared by the ruling commission and enacted by statute at the end of 2017.

At the same time, the specific anti-abuse rule for the look-through tax was strengthened to allow the application of the general anti-abuse rule.

Further, the significant increase in interest and dividend income tax, which was mentioned earlier, is another recent development, illustrating a ‘tax shift’ from very high taxation of professional income to taxation of other types of income (such as interest and dividend income) and taxation of non-sustainable behaviour and consumption.

Recent developments
Since 18 March 2018, Belgium has put in place a taxation on Belgian or foreign investment accounts held by natural persons and tax-transparent legal entities held by natural persons with qualifying assets (shares, bonds, etc.) of at least €500,000. The rate is 0.15 per cent per year on the value of the assets.

ii Inheritance tax
Belgian inheritance tax is due on the worldwide assets of the deceased if the deceased had his or her principal place of residence in Belgium at the time he or she passed away. The applicable regional tax regime is the tax regime of the residence of the deceased in the five years preceding his or her death. The top rate for descendants and spouses or partners is 27 per cent (Flemish Region) and 30 per cent (Brussels Capital Region – Walloon Region).

Recent developments
As of 1 September 2018, Flemish inheritance tax rates will be decreased for heirs other than descendants and spouses or partners: the highlight of this is the decrease of the top rate to 55 per cent (instead of the previous rate of 65 per cent). Besides this, spouses and partners are now entitled to an exemption on movable assets of up to €50,000 in the Flemish Region. It should be noted that spouses and some partners were already exempt from inheritance tax on the family home in the three regions.

Although essential aspects of inheritance (and gift) tax are regionalised, the collection of these taxes remained entrusted to the national tax administration. Since 2015, the Flemish Region collects the inheritance (and gift) tax allocated to its territory itself.

This has given rise to differing administrative interpretations of sometimes long-established legislation and practices at the national level even if the law was not altered by the Flemish parliament. Consequently, legal uncertainty arose as to some important aspects of inheritance tax law or existing planning schemes in the Flemish Region. To resolve this, the Flemish tax administration puts forward its view to issues in this regard by means of administrative positions.

An example is the residency test in the Flemish inheritance tax. The residency test refers to a complex of factual circumstances indicating that a person has his or her principal place of residence in Belgium. Contrary to Belgian income tax, Belgian (and Flemish) inheritance tax

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do not provide in a legal presumption that persons registered in Belgium (including expats and other immigrants) are considered to have their tax residency for inheritance tax purposes in Belgium (or in the Flemish Region), the principle being that presumptions overturning the burden of proof must be created by law.

If necessary, it would, therefore, be up to the tax administration to prove that the deceased was a Belgian resident for inheritance tax purposes.

The Flemish tax administration, however, proclaimed that persons registered in the Flemish Region are deemed to have their tax residency for inheritance tax purposes in the Flemish Region. The Flemish tax administration put forward that it would be up to the heirs to prove that the deceased was not a tax resident, thus overturning existing rules without altering the law. The statement by the Flemish tax administration does not mention expats or other registered immigrants in Belgium, even if they do not have their principal place of residence in Belgium. This has created legal uncertainty.

As for the Brussels Capital Region and the Walloon Region, the national tax administration continues to collect the Brussels and Walloon inheritance and gift tax. No such presumption is applicable in these regions.

iii Recent developments in income tax regarding cross-border structuring

The look-through tax, as mentioned above, should be highlighted here, as well as the tax on investment accounts.

Further, legal persons that are subject to legal persons’ income tax, such as foundations, are subject to the look-through tax on revenue of trust-like legal arrangements, legal persons or contractual arrangements of which they are settlor.

Since 1 January 2018, Belgian corporate income tax law provides a dividends-received deduction (DRD) of 100 per cent instead of the previous 95 per cent. The principle in corporate income tax is that the same conditions apply to DRD as to the capital gains exemption on shares.

In December 2016, the existing catch-all rule in the Belgian non-resident income tax regime (NRIT) was modified to the benefit of private clients. The principle is that non-resident taxpayers pay NRIT on their Belgian-source income. A catch-all rule exists to avoid non-taxation of income that would have been taxable if the taxpayer was a resident taxpayer. The catch-all rule now applies only to professional income from ‘whatever service’ the non-resident taxpayer rendered. The new rule applies retroactively on income as of 1 July 2016. If no other Belgian taxation on it is due, Belgian income of non-residents from private investments is also out of the scope of the catch-all rule.

III SUCCESSION

i Forced heirship rules

Belgium’s succession law will be modernised significantly as of 1 September 2018. Belgium will prune its forced heirship rules and adopt more flexible rules allowing donors and testators to give away or to bequeath more. However, the forced heirship principle is withheld.

Belgium’s succession law is Civil Code-based and, therefore, forced heirship rules apply. Descendants and spouses are the main protected heirs, but without descendants, spouse or legal partner, ascendants are also protected heirs. The latter changes: ascendants are no longer protected heirs.
Legal partners are not protected by forced heirship rules. They have a limited intestate claim on the inheritance (i.e., they are entitled to the usufruct of the family home).

The forced heirship rules do not prevent giving away more than the unprotected portion of one’s assets, nor do they prevent someone from bequeathing more than the unprotected portion. Protected heirs have the right to claim back what was given away beyond the forced heirship rules or may object to the execution of a will that would have failed to take care of their rights.

If the deceased has children, the unprotected portion of the estate was half the estate (one child), one-third of the estate (two children) or one-quarter of the estate (three or more children). This changes the unprotected portion being half of the estate regardless of the number of children. The spouse is entitled to at least the usufruct of half of the estate. Spouses are entitled to the usufruct of the family home, even if the value of it would be more than half of the estate. The usufruct is the right to use an asset and the right to collect the revenue of an asset.

Belgium is bound by the EU Succession Regulation. Belgian forced heirship rules may be put aside if a different applicable succession law on the basis of the regulation would be applicable following a valid and effective choice of law. To a limited extent, an agreement as to succession will become possible under Belgian law.

Contractual arrangements between spouses or legal partners determine the composition of the estate. Without a matrimonial contract, spouses have a limited community regime: earnings are common, whereas gifts and inherited assets remain outside the community. Debts are subject to specific rules. Legal partners without an agreement are subject to rules comparable to a separation of goods (i.e., the separation of income and debts).

Both options of marriage and legal partnerships are open to same-sex couples. As of 1 September 2018, Belgian matrimonial property law will also be modernised. Spouses engaging in a separation of goods are offered tools to integrate into their marriage contract if they wish to mitigate the sometimes harsh consequences of a separation of goods, especially upon divorce. Spouses that have at least one child from a previous relationship may agree in a marriage contract to waive any inheritance claims towards the other, including regarding the family home, which is a new concept. Regarding legal partnerships, the option was taken to not strengthen the minimal property rules applicable to partners.

**Co-maternity**

Since 1 January 2015, Belgium has had a co-maternity law. The female spouse of the mother of the child is automatically the co-mother of the child. The female legal partner of the mother can recognise the child and become the co-mother.

Consequently, forced heirship rules apply given the co-maternity relation between co-mothers and the children of their spouse or legal partner.

**IV WEALTH STRUCTURING AND REGULATION**

**Overview of commonly used vehicles**

Commonly used vehicles for structuring private wealth in Belgium include partnerships and corporate legal persons (i.e., legal persons that are companies). Less commonly used is the private foundation.
The principle that a trust is ruled by its applicable law is recognised in Belgium. 8 Belgian law, however, does not provide for its own trust arrangement. The principle is that trust arrangements may not violate forced heirship rules, but if the trust fund (i.e., the property held in trust) is held abroad, forced heirship claims may be ineffective.

A partnership is a body without legal personality, ruled by its by-laws (i.e., the partnership agreement). Both private individuals and legal persons may participate in a partnership. A partnership may be used as a vehicle to administer private and business assets, or as a holding company. As there are currently few legal constraints and no publication formalities to partnerships, it is a flexible and private planning instrument. However, as of 1 November 2018, this will change. Partnerships will have to be registered in the register of companies and will have to adhere to accounting rules. Existing partnerships must be compliant by the end of April 2019. Further, a partnership may facilitate a gift as the rules to administer the gift can be laid down in the by-laws instead of having to be detailed as conditions to a gift by a private individual.

Corporate legal persons are also widely used as planning vehicles, in particular as holding companies. Corporate legal persons are subject to publication formalities, but may offer a more adequate framework for asset protection and administration than a partnership, especially if more complex relations with third parties are involved. Corporate legal persons have legal personality distinct from their shareholders. Belgian law provides for a corporate legal person with only one shareholder.

Private foundations are legal persons and are construed to set apart assets for a philanthropic purpose. A private foundation does not have shareholders. Private foundations are subject to publication formalities. A private foundation is administered by at least three directors. The obligatory philanthropic purpose may be taking care of family members.

A private foundation can be dissolved once its purpose has been realised. The principle rule is that its assets must then be assigned to the philanthropic purpose. Its by-laws, however, may provide that the settlor or his or her successors may take back the property that was put into the foundation or its equivalent value if the purpose of the foundation has been realised.

ii Overview of the tax regime

Contributions of assets to a vehicle

It must be repeated that within the scope of this contribution, only the basic principles can be mentioned.

Belgian capital duty is a (national) stamp duty. Its rate has been reduced to zero per cent and cannot be increased again by Belgian law, thanks to EU legislation. 9 Contributions of movable assets to a partnership do not have to be registered in Belgium. No Belgian capital duty is therefore due.

In the (presumably uncommon) situation where immovable assets are put into a partnership that has either its centre of effective management in Belgium or its registered office in Belgium and its centre of effective management outside the EU, such contribution must be registered, but the rate is zero per cent (i.e., the contribution must be registered, but in fact no proportional capital duty is due as the rate is zero per cent).

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8 Article 124 Private International Law Code.
Contributions of assets to a corporate legal person must be registered and are subject to a capital duty of zero per cent. Belgian capital duty is due if the corporate legal person has either its centre of effective management in Belgium or its registered office in Belgium and its centre of effective management outside the EU.

To contributions of property with a residential purpose or used as such situated in Belgium, a different and more onerous tax regime applies. Such contributions are subject to the stamp duty applicable to a sale of immovable property (the basic rate is 10 per cent in the Flemish Region and 12.5 per cent in the Brussels Capital Region and in the Walloon Region.

As for contributions to private foundations, the principle is that these are subject to a flat rate of 7 per cent in the Brussels Capital Region and in the Walloon Region. In the Flemish Region the flat rate of 5.5 per cent for ‘gifts’ to private foundations also applies to contributions to a private foundation.

**Income tax**

As a body without legal personality, a partnership is considered tax transparent. Income of a private partnership allocated to private individuals is taxable on the basis of their share in the partnership. Such income is subject to personal income tax if the shareholder is a private individual and a Belgian-resident for tax purposes. NRIT may be due on the Belgian-source income of partnerships held by non-resident persons.

Belgian corporate legal persons are subject to Belgian corporate income tax (CIT). ‘Belgian’ means that the company has either its registered office, its principal establishment or its centre of effective management in Belgium.

CIT was reduced to 29 per cent in 2018 and will be further reduced to 25 per cent in 2020. For small and medium-sized enterprises, CIT is currently 20 per cent on the first €100,000 of taxable profits, subject to conditions. The purpose of these measures is to keep Belgium aligned with its neighbours and predominant trade partners.

Private foundations that have their registered office, principal establishment or centre of effective management in Belgium are subject to the legal persons’ income tax. As regards the legal persons’ income tax, only the revenue defined by law is taxable. Interest and dividend income is taxable and has to be subjected to a withholding tax (the basic rate is 30 per cent).

Since 2015 (i.e., revenue from 2015), legal persons subject to legal persons’ income tax, including private foundations, are subject to the above-mentioned look-through tax.

**Recent developments: tax on transactions in listed financial instruments**

The tax on transactions in listed financial instruments was modified on 1 January 2017. Instruments now regarded as taxable Belgian transactions include orders (such as a purchase or sale) via a foreign intermediary, either by a private individual having its principal place of residence in Belgium or by a corporate legal person acting for a registered office or an establishment in Belgium. This tax may thus also apply if no Belgian intermediary intervenes. Bonds and the like are subject to a rate of 0.12 per cent as of 8 January 2018; other financial instruments (such as shares) are subject to a rate of 0.35 per cent as of 8 January 2018 and often even 1.32 per cent.

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10 Article 19, 5° and Article 115 Stamp Duty Code.

11 Ruling 16049 of 14 November 2016.
Belgium

Inheritance tax

The share of a deceased person in a partnership is subject to inheritance tax. The same applies to the share of a deceased person in a corporate legal person.

The inheritance tax regime for private foundations is very different and may offer opportunities for private individuals that are Belgian residents for inheritance tax purposes insofar as the philanthropic purpose of the private foundation is sincere and the directors act accordingly. It is noteworthy to mention that a general anti-abuse rule also applies to inheritance tax (and gift tax).

The decision to grant benefits to a private individual, not being the settlor or one of the directors (as this is prohibited by law) and always within the scope of the philanthropic purpose of the foundation, would not be subjected to inheritance tax as this is a decision by the directors of the foundation on the basis of its by-laws. This would apply if and to the extent that the by-laws cannot be considered as a contract granting a direct right to a beneficiary. The national tax administration (competent for the Brussels Capital Region and the Walloon Region) confirmed in 2015 its previous individual rulings on the matter.12

The Flemish tax administration, competent since 2015 for gift tax within its territory, seems to adhere to this.13

The national tax administration ruled in 2014 that benefits granted by a foundation (during the lifetime of the settlor) would not be subject to gift tax or income tax. 14 The Flemish tax administration seems to adhere to this.15

Regarding trusts, the competent tax administrations have maintained their much-criticised position that benefits obtained from a trust should either be subject to inheritance tax at the time of death of the settlor (non-discretionary trusts) or at the time the benefit is granted (discretionary trusts). The notions ‘discretionary’ and ‘non-discretionary’ as used by the Belgian tax administrations may not have the same meaning under the law that governs the trust.

iii Developments in anti-money laundering rules

As the reader will be aware, Belgian lawyers, notaries, financial institutions and accountants, inter alia, are subject to strict anti-money laundering rules according to EU standards. This involves client identification obligations, including identification of ultimate beneficial owners.

Belgium implemented the Fourth Anti-Money Laundering Directive, which requires ‘corporate and other legal entities incorporated’ in Belgium to obtain and hold ‘adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held’.16 This information must be centralised and made accessible to the competent authorities and financial intelligence units of Member States ‘without any restriction’.

12 Ruling No. 2015.083 of 13 May 2015. A ruling is a decision on a case-by-case basis and does not apply to other cases.
13 Ruling 16049 of 14 November 2016.
15 Ruling 16049 of 14 November 2016. The ruling does not deal with income tax.
Belgian financial institutions have to file the identity of their clients and the reference number of their contracts (not the amounts or transactions) to a central register. This register has been made accessible for all tax matters. It is not only the tax administration that has access to the central register but also notaries, etc.

V OUTLOOK AND CONCLUSIONS

The Belgian capital gains tax regime remains friendly to private individuals, as capital gains within the scope of the normal administration of private assets are tax exempt.

Gifts of movable assets do not have to be subjected to Belgian gift tax; however, inheritance tax may apply afterwards.

There is a large consensus in Belgium that aggressive tax evasion should be tackled effectively and to some extent there is a tendency to gold-plate international rules or standards on the matter. Other tax-evasion schemes (e.g., dealings within a group of companies) were also curbed in recent years. The greater scope of the Belgian tax on transactions in listed financial instruments may also be mentioned.

The previous government introduced an obligation for private individuals who are Belgian residents for tax purposes to declare trust-like legal arrangements and not-taxed or low-taxed foreign legal persons in their yearly income tax return. The present government enacted a look-through tax for these legal arrangements and legal persons, applicable to private individuals and legal persons, subject to legal persons’ income tax.

As of 2018, CIT will be decreased gradually to the rate of 25 per cent in 2020. For small and medium-sized enterprises CIT is 20 per cent, subject to conditions.

The new succession law eases Belgian forced heirship rules and thus grants more planning opportunities and flexibility to private individuals. The new succession law also allows, within boundaries, agreements as to succession. The second phase of this modernisation has also been enacted: a new matrimonial property law.

Belgian company law will also be modernised significantly in the near future. The guiding principles here are to reduce the number of corporate structures and to enable more flexibility as to enhance the attractiveness of Belgian corporate structures, in particular from an international perspective. The ‘nationality’ of companies would also be determined on the basis of the registered office of the company.
Chapter 10

BERMUDA

Alec R Anderson and Stephanie C Bernard

I INTRODUCTION

Bermuda has long been recognised as an attractive, sophisticated and secure jurisdiction for private wealth management for the international private client. It is the United Kingdom’s oldest overseas territory and has been self-governing since 1622, with a strong economy primarily as a result of its trust, insurance and reinsurance, and investment fund sectors supported by a sophisticated and well-established advisory and financial services infrastructure.

Bermuda has an independent, stable legal and judicial system, and over the past 20 years has made regular and innovative reforms of its trust laws with trust legislation that are both modern and facilitative with regard to succession planning and asset protection. In implementing new trust legislation, Bermuda’s legislature collaborates with private sector associations such as the Bermuda Association of Licensed Trustees and the Society of Trusts and Estate Practitioners, as well as the Bermuda Business Development Agency, an organisation created to support international business. Recent legislative initiatives in the trusts arena include new legislation on know-your-customer safeguards and record-keeping for trusts. This cooperative approach and innovative modernisation initiatives demonstrate the willingness and ability of Bermuda to adapt to changing product needs of clients around the world.

Bermuda’s trust law is largely based on English common law, including the doctrines of equity, but it has been enhanced and amended by Bermuda trust-related legislation. English common law remains of highly persuasive authority in Bermudian courts. The Supreme Court of Bermuda is the court of first instance in Bermuda with the right of appeal in certain circumstances to the Court of Appeal in Bermuda. The ultimate right of appeal lies to the Privy Council of the United Kingdom.

Two key pieces of legislation in Bermuda are the Trustee Act 1975 (the Trustee Act) (as amended by a number of statutory instruments, including the Trustee Amendment Acts of 1999, 2004 and 2014 and most recently the Proceeds of Crime Amendment (No. 3) Act 2017 and the Proceeds of Crime (Miscellaneous) Act 2018 and the Trusts (Special Provisions) Act 1989 (the Special Provisions Act) (as amended by the Trusts (Special Provisions) Acts of 1998, 2004 and 2014). The Trustee Act is largely patterned on the English Trustee Act 1925. It grants certain powers to trustees of Bermuda trusts, which apply unless excluded by express terms in the relevant trust deed and, pursuant to the 1999 Amendment Act, also provides for delegation of certain trustee functions and modern trustee investment powers. The most recent changes introduced new rules concerning financial records and other information.

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1 Alec R Anderson is a director and Stephanie C Bernard is an associate at Conyers Dill & Pearlman.
that must now be maintained for trusts that have individual and non-professional trustees. There are exemptions to these new rules where there is a co-trustee licensed under the Trusts (Regulation of Trust Business) Act 2001 (the Trust Business Act) or a licensed trustee under the Trust Business Act appointed to maintain the trust records. With the Special Provisions Act, Bermuda was the first offshore jurisdiction to introduce legislation permitting non-charitable purpose trusts with most other international financial centres subsequently following Bermuda’s lead by incorporating the concept into their legislation. The Special Provisions Act also contains a number of other innovative and modern provisions that include some of the terms of the Hague Convention on the Recognition of Trusts 1987, which applies in Bermuda.

Bermuda was also one of the first offshore jurisdictions to introduce modern and flexible legislation on private trust companies (PTCs), with over 40 years’ experience establishing and administering PTCs. Unlike PTCs in some other jurisdictions, Bermudian PTCs have never been required to be licensed and so the incorporation and conduct of their affairs has been straightforward, private and efficient.

Bermuda has robust anti-money laundering legislation and tax information exchange agreements (TIEAs), which has led to the Organisation for Economic Co-operation and Development (OECD) including Bermuda on its white list as a cooperative and compliant jurisdiction. In fact, Bermuda has now signed 44 TIEAs (including three double tax conventions), including with the United States and the United Kingdom. On 19 December 2013, Bermuda signed a Model 2 intergovernmental agreement with the US Treasury under the US Foreign Account Tax Compliance Act (FATCA). Bermuda has also entered into a similar agreement with the United Kingdom. Additionally, it committed to a wider exchange of information process with the G5 countries of the European Union and signed a Multilateral Competent Authority Agreement to exchange information using the Common Reporting Standard (CRS) framework since 2017.

Bermuda’s anti-money laundering legislation, along with the regulatory enforcement provided by the Bermuda Monetary Authority (BMA), has ensured that Bermuda is a leader in international anti-money laundering measures, reinforcing Bermuda’s status as a premier offshore jurisdiction.

II TAX

In Bermuda there is no income or profits tax, withholding tax, capital gains tax, capital transfer tax or inheritance tax. There is no exit or similar tax based on a resident’s wealth when ceasing to be resident, and there are no other consequences of leaving the jurisdiction. Customs duties and stamp duties are major government revenue earners, with stamp duties charged at different rates and in different manners on a variety of legal documents, excluding wills.

The Stamp Duties Act 1976 is the governing legislation. However, pursuant to the Stamp Duties (International Businesses Relief) Act 1990, no stamp duty is imposed on instruments to which international businesses are a party and there are certain exemptions in the trust area in respect of instruments dealing with foreign currency denominated assets so that generally the imposition of stamp duty is of minimal impact in relation to the international private client. Exemptions from stamp duty are applicable in respect of registered pension trust funds and trusts of non-Bermudian property that are executed by a local trustee, as well as trusts to which an international business is a party and in respect of transactions involving shares in Bermudian-exempted companies and publicly listed...
local companies. Non-Bermudian property basically refers to all assets except Bermudian currency-denominated assets, Bermuda land and shares in non-listed local companies. There is no ad valorem stamp duty on non-Bermudian property in the trust context.

There are no gift taxes in Bermuda on lifetime gifts, although stamp duty may be payable in respect of certain gifts or transfers of movable or immovable property where a transfer document is executed. In relation to any such property that is not Bermudian property for the purposes of the Act (if an applicable exemption is not available), the rate of stamp duty is 1 per cent of its value. The subject matter of voluntary transfers must be adjudicated as to value by the Tax Commissioner and stamped accordingly for the transfer deed to be deemed properly stamped. Conveyances of Bermudian real estate attract stamp duty at a sliding rate related to value, as follows: 2 per cent on the first Bda$100,000, 3 per cent on the next Bda$400,000, 4 per cent on the next Bda$500,000, 6 per cent between Bda$1 million and Bda$1.5 million, and 7 per cent over Bda$1.5 million. Transfers of shares in publicly listed, exempted or foreign companies are stamp duty-exempt.

Transfers of non-Bermudian property to a charitable trust are stamp duty exempt and transfers of Bermudian property to such a trust will also be exempt if: (1) the trust constitutes a charity that is registered under the Charities Act 1978; or (2) the trust's purposes are in favour of a body of persons or institutions whose purposes, in the opinion of the Minister of Finance, are charitable. Exemption (2) principally applies to charities operating locally in Bermuda where the trust affords a benefit to Bermuda.

Although there is no inheritance tax as such in Bermuda, stamp duty may be payable in respect of affidavits of value filed on applications for grants of probate or letters of administration depending on the net value of any Bermudian property comprised therein. The first Bda$100,000 of the net estate value (i.e., assets less debts) is stamp duty free, the next Bda$100,000 attracts duty at a rate of 5 per cent, the next Bda$800,000 at 10 per cent, and the next million at 15 per cent, and 20 per cent duty is levied for everything over Bda$2 million.

As Bermuda does not impose income tax it has not entered into any full double taxation treaties with other countries although, as noted earlier, it does have a number of tax information exchange agreements with various countries, some of which contain provisions relating to foreign taxes. Additionally, as alluded to above, Bermuda has signed a Model 2 agreement with the US Treasury under FATCA and has entered into a similar agreement with the United Kingdom. As noted above, CRS also applies in Bermuda.

Predominantly, the private client trust work in Bermuda involves settlors and families who are not residents of Bermuda. It is common for several jurisdictions to be involved if the various beneficiaries are resident in different countries or if the assets owned by the trust are located in different jurisdictions. Consequently, Bermudian lawyers regularly engage with onshore tax lawyers or tax accountants in the relevant jurisdictions to ensure the tax-efficient structuring of any Bermudian entities created for the international private client.

III SUCCESSION AND LAND OWNERSHIP

The concept of freedom of testation sets Bermuda apart from various civil law jurisdictions, where such freedom may be curtailed by compulsory inheritance provisions. Bermuda, as

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2 Section 39(1) of the Stamp Duties Act 1976.
3 Head 15, Schedule to the Stamp Duties Act 1976, exemptions c and d.
an established and forward-thinking jurisdiction for wealth management, has utilised and expanded on the concept of the trust for estate planning and asset protection purposes. The concept is, however, subject to statutory checks designed to preserve the integrity of the jurisdiction by avoiding dispositions to defeat eligible creditors as that term is defined in the Conveyancing Act 1983.\(^4\) There are also laws to ensure that natural family obligations are met;\(^5\) however, it should be noted that for the purposes of succession, Bermuda currently does not recognise common-law marriage, same-sex marriage or civil unions. Accordingly, persons in such relationships have no rights to inherit from a deceased partner in the absence of a will.

Intestate succession is governed by the Succession Act 1974, which specifies who can inherit the property (both real and personal, without distinction) of a person dying intestate. Section 5 of the Act contains various case scenarios based on who survives the intestate, and all offspring (whether born in or out of wedlock)\(^6\) have equal rights to succession in the various cases. The rationale of Section 5 is that family members with the closest nexus are benefited in priority to those with a more remote connection.

The Act also contains provisions similar to the United Kingdom's Inheritance (Provision for Family and Dependants) Act 1975, giving certain family members and dependants the right to make a claim against a decedent's estate (whether dying intestate or not) on the basis that adequate provision was not made for them.

The Wills Act 1988 codifies the law relating to the formalities pertaining to, and validity of, wills. These provisions generally follow English law. Bermuda is not a party to the Hague Convention on the Conflicts of Laws relating to the Form of Testamentary Dispositions; however, to facilitate international estate planning, the salient provisions of the Convention have been inserted in the Act:

A will shall be treated as properly executed if its execution conformed to the internal law in force in the territory where it was executed, or in the territory where, at the time of its execution or of the testator's death, he or she was domiciled or had his or her habitual residence, or in a state of which, at either of those times, he or she was a national.\(^7\)

The Administration of Estates Act 1974 governs the scope of the duties and powers of executors and estate administrators. It also makes provision for the resealing of foreign probate or administration grants in the Bermuda court, under which reseal a foreign executor or administrator would derive his or her authority to administer any Bermudian property covered under the provisions of the foreign estate.

The ability to reseal a foreign grant, however, is limited to grants that were made by a court in the United Kingdom or any British possession, colony or dependency, or a member nation of the Commonwealth or the District of Columbia or any state of the United States. In situations where a foreign national dies owning Bermudian property, the devolution of which is governed only by a foreign will, such will would have to be probated in the Bermudian courts.

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4 Section 36.
6 Children Amendment Act 2002.
7 Section 37 of the Wills Act 1988.
Where a person dies domiciled outside Bermuda, Rule 27 of the Non-Contentious Probate Rules 1974 allows the Registrar to issue a grant to the person entrusted with the administration of the estate by a foreign court, or to the person entitled to administer the estate by the law of the place where the deceased died domiciled.

In the event a foreign national dies owning Bermudian real estate, then his or her estate representative is subject to a time limit within which to apply for permission from the Department of Immigration for a certificate entitling him or her to defer the application for a licence to hold the land.°

Ownership of land by foreigners in Bermuda is closely regulated and each foreign owner must have a licence to own land. The ability of a foreign owner to pass real property on to heirs is subject to the property falling in a category that qualifies it for foreign acquisition. The main qualifying factor for foreign persons, with no special nexus to Bermuda by way of family ties or permanent residence, is that the real property in question must have an annual rental value over a certain value (Bda$126,000 for freehold properties and Bda$25,800 for certain leasehold properties).

IV WEALTH STRUCTURING AND REGULATION

Bermuda trusts are the primary legal vehicle of choice used to provide wealth-preservation structures to the high net worth international client. Bermuda trusts can be employed to achieve a variety of estate, personal, financial, tax or other business planning objectives including provision for inheritance by spouses and dependants; protection of assets from unforeseen, future personal liability; minimisation of estate or inheritance tax, income tax and capital gains tax; preservation of family wealth and continuity of family businesses; efficient and timely distribution of assets upon death; protection against exchange controls or political instability; making provision for charities or philanthropic purposes; and confidentiality of ownership of assets.

i Bermuda trusts

While the trust concept is well defined in the common law, statutory clarity as to the characteristics of a Bermuda trust is found in the Special Provisions Act, which codifies the common law position and states that the term 'trust' refers to the legal relationship created, either inter vivos or on death, by a person, the settlor, when assets have been placed under the control of the trustee for the benefit of a beneficiary or for a specified purpose.

The beneficiaries of a Bermuda trust may be individuals, companies and other legal entities. The settlor of a Bermuda trust may be an individual over the age of 18 years or a corporation if it has the corporate capacity to make a gift of its assets or otherwise dispose of them for the purpose of establishing a trust.

There are no Bermudian residency requirements with respect to the trustees of a Bermuda trust who may be individuals, PTCs or public trust companies. The property constituting the trust fund can be any type of real or personal property (e.g., cash, securities, real estate, personal effects or other tangible or intangible property). It is common in Bermuda trusts to designate a protector, who may be an individual or a corporation. There is no definition of a ‘protector’ in the statutes or case law of Bermuda or provisions specifying the functions and

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8 Section 85 of the Bermuda Immigration and Protection Act 1956.
duties of a protector other than the Special Provisions Act, which provides that a protector or enforcer may be appointed to enforce a purpose trust. The general law treats protectors in accordance with their functions and duties as stipulated in the trust document itself. The nature of a protector's powers will determine how the court treats them. For example, a protector's power to appoint and remove trustees has been determined by the Bermudian courts to be fiduciary in nature (though the reserved powers legislation permits certain powers to be characterised by the trust instrument as non-fiduciary).

There are no public registration requirements or other disclosure requirements concerning the establishment of trusts in Bermuda. Trust records kept by a trustee are generally not disclosed to regulatory authorities or third parties unless required by law. All information passing from a settlor to the trustee is treated by the trustee as private and confidential. Such information will only be disclosed to beneficiaries on a case-by-case basis where permitted by the trust deed or as required by the trustee's fiduciary duties.

While Bermuda's trust law substantially reflects English law and principles of equity, Bermuda has enacted legislation designed to facilitate the use of trusts for modern commercial and private client applications.

Sections 23 and 24 of the Bermuda Trustee Act are almost identical to Subsections 31 and 32 of the English Trustee Act, with one notable difference in Section 24(1)(a) of the Bermuda Trustee Act, which (unlike the English Trustee Act) does not restrict the exercise of the power of advancement to one half of the presumptive share of a beneficiary. Section 24 of the Act confirms that the statutory power of advancement may be exercised by transfers to other discretionary trusts and to permit delegation of duties. This amendment provides flexibility to those trusts that do not contain express delegation powers.

The Trustee Amendment Act 2004 repealed Section 24(3) of the Trustee Act to enable the statutory power of advancement to apply to all trusts governed by Bermudian law whenever created and not just to trusts created after 1 March 1975. This change allows trustees, through the exercise of a power of advancement, to modify the terms of a trust to adapt to the modern environment, and thereby ensure that the trust better reflects the original intentions of the settlor.

Section 47 of the Trustee Act (Section 47) (which is a hybrid of the language of Section 57 of the English Trustee Act and Section 64 of the English Settled Land Act 1925) confers on trustees and beneficiaries of Bermuda trusts advantages that are not available under English law. Like Section 57 of the English Trustee Act, Section 47 allows the court to authorise trustees to enter into otherwise restricted transactions where the court is satisfied that the transaction is expedient and for the benefit of the trust as a whole. The English court's jurisdiction under Section 57 is limited to matters of management and administration of the trust property and does not sanction changes in equitable interests or dispositive provisions. By contrast, the Bermuda court's jurisdiction under Section 47(4) broadens the ambit of authorised transactions by importing the provisions of Section 64(2) of the Settled Land Act 1925. ‘Transaction’ is defined in both Section 64(2) and in Section 47(7) to include any disposition, application of capital or other dealing or arrangement. The breadth of this definition of transaction assists the justification of the court's jurisdiction to approve the potential modification of the beneficial provisions under a trust.

The provisions of Section 47 may be employed by trustees wishing to secure authority to distribute income where failure to do so would incur tax penalties or approval of the exercise of a power of advancement that may technically be outside the scope of the power but that achieves a tax-driven restructuring.
Unlike applications to vary trusts under the English statute, under Section 47 the consent of all beneficiaries is not required. This proves beneficial where general consent by beneficiaries would trigger adverse tax consequences or where obtaining consent from a particularly broad beneficial class would be cumbersome.

Choice of governing law provisions may be inserted in trust instruments by virtue of the Special Provisions Act, with the ability to have a severable part of a trust (such as a part dealing with administration matters) governed by a different law. The Special Provisions Act, in Section 11, also preserves the primacy of the Bermuda court in having sole jurisdiction with respect to trusts validly created in Bermuda and further precludes the recognition or enforcement of foreign judgments insofar as they are inconsistent with this particular section of the Act.

Section 10 of the Special Provisions Act codifies the previously unclear common law position as regards capacity to create a trust by stipulating that in respect of movable property (not real estate) that the settlor is deemed to have capacity to create an inter vivos trust if he or she would have had capacity under the domestic laws of Bermuda. Where a trust of movables is created by a will, the question of capacity is determined by the law of the domicile of the testator. Where the trust property is land, the question of capacity is determined by the law of the jurisdiction in which the property is situated.

Section 10(2) also excludes the application of foreign rules of law to questions of capacity of a settlor of a trust governed by Bermudian law.

The Trusts (Special Provisions) Amendment Act 2004 amended Sections 10 and 11 of the Special Provisions Act to clarify that a trust validly created under Bermudian law can only be varied or set aside pursuant to the laws of Bermuda. This makes it clear that provisions of foreign laws giving rise to interests under marriage or analogous relationships, forced heirships and creditors’ rights will not be permitted to vary Bermuda law trusts.

Foreign judgments based on such laws or rights will not be recognised in Bermuda; for example, a foreign court order in a divorce dispute purporting to vary a Bermuda law trust in circumstances where the Bermudian trustee was not a party, will not be enforced in Bermuda.

The Special Provisions Act also legitimates and regulates the use of non-charitable purpose trusts for estate planning. For such a trust to be valid under Bermudian law, it must:

a be sufficiently certain to allow the trust to be carried out;
b be lawful; and
c not be contrary to public policy.

The Act also requires such trusts to be made in writing and conveniently exempts them from the application of the rule against perpetuities, although such trusts are precluded from owning any interest in land in Bermuda, directly or indirectly.

The Perpetuities and Accumulations Act 2009, which came into force in Bermuda on 1 August 2009, disapplied the common law rule against perpetuities in relation to all Bermudian law instruments taking effect on or after 1 August 2009, except in respect of trusts holding Bermudian real estate. For the purposes of the 2009 Act, instruments include

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10 Section 8 of the Trusts (Special Provisions) Act 1989.
11 Section 11(2) of the Trusts (Special Provisions) Act 1989.
12 Section 12A(2) of the Trusts (Special Provisions) Act 1989.
inter vivos trusts settled on or after 1 August 2009 and trusts drafted under wills executed on or after 1 August 2009. The ability to create perpetual trusts provides greater flexibility and opportunity in multigenerational wealth and tax planning. The Act does not change the application of the rule to trusts created before the operative date of the Act (Pre 2009 Trusts). However, the perpetuity period of Pre 2009 Trusts can be extended under the existing law by application to court. The process of extending the perpetuity period of Pre 2009 Trusts was made even more streamlined and cost-effective by the Perpetuities and Accumulations Amendment Act 2015.

Further legislative modernisation includes amendments to the Special Provisions Act to introduce innovative reserved powers provisions. Subsection 2A(2) of the Special Provisions Act lists certain interests and powers that can be retained by a settlor or granted to a third party (e.g., a protector or beneficiary) without prejudicing the validity of a trust (i.e., without laying the trust open to attack on the basis that it is a sham, or an allegation that its assets are not trust property but should be regarded as part of the settlor's personal estate).

The powers listed (which are non-exhaustive) include powers to:

- revoke the trust;
- vary or amend the trust;
- decide on distributions of trust property;
- direct investments;
- appoint, add, remove or replace trustees, protectors, enforcers or other office holders or advisers;
- add, remove or exclude beneficiaries or purposes; or
- change the governing law of the trust.

The Special Provisions Act (as amended) clarifies that the holder of such a power will not (unless formally appointed as trustee) be deemed to be a trustee by reason only of the grant or reservation of the power.

It also authorises a trust deed governed by Bermudian law to provide that the person who holds the powers listed in Subsection 2A(2) shall not be subject to a fiduciary duty. This is helpful where, for example, powers are being given to protectors who are family friends. Further, it creates certain presumptions (which can be overridden by the terms of the trust) about when reserved power holders will or will not be fiduciaries.

Bermuda has also enacted legislation to restore the ‘rule in Hastings-Bass’ as it stood prior to the English Court of Appeal (2011) and Supreme Court (2012) decisions in Pitt v. Holt and Futter v. Futter. Pursuant to Section 47A of the Trustee Act, if: (1) a fiduciary has failed to take into account a ‘relevant consideration’ or has taken an ‘irrelevant consideration’ into account; and (2) but for this flaw in his or her decision-making, the fiduciary would not have exercised the power; would have exercised it but on a different occasion to that on which it was exercised; or would have exercised the power, but in a different manner to that in which it was exercised, then the court has a discretion to set the exercise of the power aside in whole or in part. The legislation clarifies that breach of trust or fiduciary duty is not a necessary component in the exercise of the court’s Hastings-Bass jurisdiction.

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13 See the Trust (Special Provisions) Amendment Act 2014, which became effective on 16 July 2014.
14 See the Trustee Amendment Act 2014, which became effective on 29 July 2014.
ii PTCs

Integral to multigenerational wealth planning requirements involving trusts is the use of PTCs, which offer a host of benefits to private clients and their families, including: (1) the ability to have more involvement in or control over the administration of their trust assets, where tax considerations permit; (2) the involvement of family members or close family advisers on the board of directors who will have more familiarity with the settlor’s family and affairs than an institutional trustee, and will be able to provide more continuity in terms of management personnel (directors and administrators) than an institutional trustee that may have a high turnover of staff; (3) greater control of the circulation and disclosure of confidential information relating to the trust and a family’s affairs than might be the case with an institutional trustee; and (4) administrative flexibility, as the PTC structure can be tailor-made to best serve the settlor’s intentions. PTCs allow for the harmonisation of trusteeship among a group of trusts that may be governed by laws of different jurisdictions and dispenses with the need to have trustees in each country. Grouping assets into one structure is a particularly convenient planning tool for multinational families.

A PTC may be incorporated in Bermuda if its objects are limited to acting as trustee or co-trustee of a single or specified group of related trusts. In Bermuda, a PTC can be incorporated either as a company limited by shares (which may have different classes of shares (i.e., voting and non-voting)) or as a company limited by guarantee pursuant to the provisions of the Companies Act 1981. Guarantee companies are the preferred structure for PTC formations since the directors and members can be the same individuals. This simplifies the structuring. In some circumstances, where ownership of shares by the settlor would be tax disadvantageous, a PTC may be owned by a non-charitable purpose trust as a means of orphaning ownership.

A PTC will typically be incorporated as an exempted company. Bermuda law distinguishes between local companies (those that are predominantly owned by Bermudians) and exempted companies (those that are predominantly owned by non-Bermudians). Generally, with some exceptions, exempted companies may only carry on business from Bermuda in connection with transactions and activities that are external to Bermuda. PTCs are permitted to carry on their business wholly in Bermuda where the settlor is not ordinarily resident in Bermuda at the time of the creation of the relevant trust.

The application to incorporate a PTC is made to the BMA, which must approve the incorporation of all exempted Bermudian companies. It is a requirement that the identity of the ultimate beneficial owners must always be disclosed and each ultimate beneficial owner holding 5 per cent or more of the shares of the proposed PTC must sign a personal declaration attesting to his or her good standing in any other Bermudian operations or generally. Where, as is common, the company is owned by a purpose trust, the settlor of the underlying trusts should make the declaration. After the BMA’s consent is obtained, the memorandum of association is filed with the Registrar of Companies to incorporate the PTC. The memorandum will set out the objects that specifically recite the name of the trust or trusts that the company is to be trustee of or the name of the family who will be beneficiaries of the trust or trusts. The incorporation process normally takes about one week from the date of submission of the complete application with supporting information to the BMA.

Every Bermuda exempted company is required to have: at least one director who is ordinarily resident in Bermuda; a secretary that is ordinarily resident in Bermuda; or a resident representative that is an individual or a company that is ordinarily resident in Bermuda. If
the PTC is incorporated as a company limited by shares, it must have a minimum of one shareholder, and the names of all shareholders must be maintained in a register of members that is maintained in the company’s registered office.

iii Regulation and anti-money laundering

The Trusts (Regulation of Trust Business) Act 2001, which came into effect on 25 January 2002, was passed as a result of recommendations of the KPMG report on Bermuda. It covers the regulation of trust companies and individual trustees with a view to upholding international standards in the provision of trust services to local and international clientele. It provides that any person who carries on trust business in or from Bermuda must be licensed unless he or she is covered by an applicable exemption. Trust business is defined as ‘the provision of the services of a trustee as a business, trade, profession or vocation’.

There are two types of licences available: unlimited and limited. Only trust companies are permitted to hold unlimited licences whereas individuals or partnerships are restricted to limited licences. A limited licence trustee may only hold trust assets in an amount not exceeding an authorised amount. The underlying policy objective is that all trust business of significant size and complexity should be conducted inside a licensed, and therefore regulated, trust company. Trust licensees are regulated by the BMA.

As mentioned above, a PTC is exempted from the licensing requirements although it is required to make a one-time filing of a letter to the BMA stating that: (1) the nature and scope of its business is limited to the objects as set out in the memorandum of association; and (2) confirming that the company qualifies for exemption.

Know-your-customer safeguards impose statutory duties on non-professional trustees, licensed trustees, professional legal advisers, professional accountants and corporate service providers. The Proceeds of Crime (Anti-Money Laundering and Anti-Terrorist Financing) Regulations 2008 (the Regulations) as amended by the Proceeds of Crime Amendment (No. 3) Act 2017 and the Trustee Act as amended by the Proceeds of Crime (Miscellaneous) Act 2018 necessitate verification of the identity of customers and beneficial owners (including settlors, protectors, beneficiaries and any other natural person exercising ultimate effective control over the trust), close monitoring of business relationships, recognition and reporting of suspicious transactions, maintenance of records for a prescribed period, assessment and management of risks based on criteria set out in the Regulations as amended, as well as training for employees and staff.

Corporate service providers in Bermuda are required to be licensed and are regulated under the Corporate Service Providers Business Act 2012 (the CSP Act). Undertakings that carry on company or partnership formation, nominee, registered office, secretarial and other similar services are required to apply for a licence from the BMA. The BMA has broad powers of supervision and the ability to impose penalties should a licensed entity fail to comply with its obligations under the CSP Act.

V OUTLOOK AND CONCLUSIONS

Bermuda continues to build on its established reputation as a centre of excellence for offshore trust and estate planning. Bermuda’s trusts, corporate and other products can be used in a broad array of private and commercial transactions with its legislation reviewed and updated regularly to assist in meeting and adapting responsively but responsibly to changing client requirements, as demonstrated by the 2014 and 2015 legislation dealing with settlor reserved
powers, the statutory Hastings-Bass rule and perpetuities. Looking forward, there will very likely be further legislative developments with a view to continuously improving Bermuda’s technical financial services and providing new vehicles to enhance the wealth planning options available to the international private client.

For many private clients affected by the current volatile economic climate, the events of recent years may have resulted in increased pressure on the clients personally and on their trust structures. This has resulted in an increase in trust-related applications to Bermuda’s courts to seek amendment to the structures for tax efficiency purposes. Bermuda’s courts are well equipped to deal expeditiously and cost-effectively with both contentious and non-contentious applications. There is robust judicial support for the quick and efficient resolution of such applications, with the courts showing a sensible pragmatic approach to assisting clients with a variety of matters including trust restructurings. With its responsive and cooperative approach to the demands of international initiatives in relation to regulation, transparency and anti-money laundering, as evidenced by the recent amendments to its know-your-customer Regulations and Trustee Act, as well as by the 44 TIEAs it has entered into, and in providing innovative solutions to the changing needs of the international client in light of such initiatives and tax policy and other developments in their home jurisdictions, Bermuda is well placed to maintain its position as a leading international financial centre for private wealth management and planning.
BRAZIL

Silvania Tognetti

I  INTRODUCTION

Brazil is a jurisdiction home to individuals with significant wealth. Owing to political and economic instability, wealthy individuals often use foreign jurisdictions to protect parts of their assets. For decades, having assets in international banks that were not registered before the Brazilian authorities was very common among Brazilians, even though it was considered a crime.

Nowadays, however, following the alignment of national policies with the international initiatives of tax transparency, control of base erosion and profit shifting – led by the G20 and the Organisation for Economic Co-operation and Development (OECD) – Brazilian individuals have been invited to review their compliance with tax rules and their wealth management has been an important part of this procedure.

In view of the latest changes in international rules, which led to a greater transparency regarding financial assets, Brazilians are currently facing a new challenge: to manage assets held internationally with full disclosure to Brazilian tax authorities.

Brazil has a complex tax system, and any transaction requires careful analysis: errors or inaccuracies can lead to heavy fines and sanctions by the Treasury. Therefore, investment in private wealth management advisory can represent important savings to a private client through compliance with the tax system.

Furthermore, estate planning has been in full development in the last few years in Brazil. The country has good opportunities for companies and professionals that intend to offer their capabilities to wealthy individuals.

II  TAX

Individuals resident in Brazil are taxed on their worldwide income, and non-residents are taxed exclusively on their income sourced in Brazil. The residence of the income payer determines the source of the income, regardless of where the work is performed.

To be considered an individual resident in Brazil, a foreigner living in Brazil should meet one of these requirements: hold a permanent visa or hold a temporary visa on the date of arrival in Brazil while: working under a labour agreement; residing in Brazil for more than 183 days (not necessarily consecutive) in any given 12-month period; or obtaining a permanent visa or a labour agreement before the 184th day of residence in Brazil, within a 12-month period.
There are no special tax conditions or concessions for foreigners living permanently or temporarily in Brazil.

All departing foreigners (holders of temporary visas, with labour agreements or permanent visas) or Brazilians that decide to live permanently or temporarily abroad should notify the Brazilian Federal Revenue of their departure and file an individual income tax return regarding the period from 1 January up to the departure date.

Afterwards, the foreigner or Brazilian citizen is no longer considered resident in Brazil and as of that moment all income and gains earned in Brazil will be taxed at source (at a flat rate of 25 per cent), except on financial investments, which are taxed at the same rates applicable to Brazilian residents, as described below.

### Income tax

Every year, by the end of April, the Brazilian individual taxpayer must file a tax return form declaring all income and gains received in the previous tax year (1 January to 31 December), including prizes, bonds, wages, commissions and other kinds of remuneration. The taxable income is very broad and includes everything that is directly or indirectly connected with work or assignment remuneration packages (salaries, 13th month salaries, bonuses, premiums, tips and other gratuities and allowances of any kind).

Stock option agreements are not covered by special tax legislation.

There is no legal option to obtain a deadline extension for filing tax return forms, and each form filed late is subject to an interest charge (calculated according to the financial market, which in Brazil can represent more than 10 per cent per year, but recently is around 6 per cent per year) and penalty (25 per cent levy due tax or a minimum fixed amount, in case taxes are not due). All income tax due shall also be paid until such deadline or in six instalments, with interest.

Income tax in Brazil has a lower rate than in other jurisdictions. On the other hand, the tax basis is higher because there are only few tax deductions and there are certain incomes that are segregated to be taxed without any deduction. Education expenses, for example, may be deducted to the limit of 3,561.50 reais. For dependants (e.g., children, stepchildren or spouse), the limit is 2,275.08 reais per person, per year.

The income tax rates are progressive and follow a table that changes with the effect of inflation on Brazilian currency (the progressive table):

<table>
<thead>
<tr>
<th>Monthly income (BRL)</th>
<th>Percentage</th>
<th>Deduction (BRL)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,903.98</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1,903.99 up to 2,826.65</td>
<td>7.5</td>
<td>142.80</td>
</tr>
<tr>
<td>2,826.66 up to 3,751.05</td>
<td>15</td>
<td>354.80</td>
</tr>
<tr>
<td>3,751.06 up to 4,664.68</td>
<td>22.5</td>
<td>636.13</td>
</tr>
<tr>
<td>Above 4,664.68</td>
<td>27.5</td>
<td>869.36</td>
</tr>
</tbody>
</table>

There are exceptions to the income tax progressive rates, such as capital gains, interest and revenue derived from financial instruments and income derived from the stock market.

As a general tax regime, entities withhold all payment to individuals on the amount calculated according to the progressive rates. On their annual income tax return, individual taxpayers declare all revenues from the preceding calendar year together with the entire
amount withheld. After considering income, taxes withheld and authorised deductions of expenses, taxpayers verify the actual annual income tax and pay or request a reimbursement of the difference from the taxes already paid during the previous year.

When an individual receives payment of revenue from another individual (or from a foreign individual or entity) he or she has to calculate the corresponding taxes according to the progressive table, and perform a provisional payment. The provisional amount in a year will be considered in the following year’s tax return (as described above) for the income tax withheld on payments received from Brazilian entities.

Earnings from real estate rentals located in Brazil, received by non-residents, are subject to income tax withheld at source at a flat rate of 15 per cent.

There are no special tax rules for shareholders or quota-holders of closely held corporations or private limited liability companies.

Care must be taken to ensure that shareholders’ or quota-holders’ transactions are perceived to be at arm’s length and, therefore, not deemed to be disguised profit distributions, which are subject to income tax.

The following tax exemptions are worth mentioning:

- equipment, clothing, board and transport provided free of charge by the employer, or the difference between the amount charged for these items and the market value;
- reimbursement of relocation costs when moving to a different area at the request of the employer;
- allowances to cover expenses when working outside the location in which the work is normally performed;
- indemnities in general, including indemnities for work-related accidents;
- contributions made by the employer to private social security programmes on behalf of employees;
- dividends received from a Brazilian corporate entity; and
- increase of corporate capital in kind.

ii Capital gains tax

With some exceptions, capital gains of individuals resident in Brazil are taxed at a progressive rate of 15 per cent to 22.5 per cent, depending on the total amount of the gain. This applies to assets and rights located both in Brazil and abroad.

There may be, however, an exemption (considered monthly) depending on the asset or right being sold where the sale price is less than 35,000 reais (or 20,000 reais for over-the-counter market shares). The sale of an individual’s principal residence is also exempt up to 440,000 reais.

Capital gains of non-resident individuals are subject to withholding tax of 15 per cent to 25 per cent, except for financial income held in bank accounts in Brazil, which may be subject to lower rates.

This tax is also applied to foreigners abroad if the assets are located in Brazil; worth considering especially in real estate sales and investments in Brazilian companies.

For capital gains earned in reais, the variation of the exchange rates from the moment of acquisition to the point of sale will be considered on the calculation of the tax basis.

In the case of capital gains earned in foreign currency, the variation of exchange rates will not be considered. The calculation will consider to the exchange rate at the point of sale.
iii Other taxes
Despite it being in the Constitution, Brazil does not have a wealth tax. However, there is an ongoing discussion among the political parties about its creation.

Gift and inheritance tax is at the state level and cannot be higher than 8 per cent. Each state has a different rate but, in general, Brazilian states apply a 4 or 5 per cent rate calculated over the asset’s market value or in case of interests in privately held companies, the net equity value of the company.

The taxpayer, in this case, is the donor. However, if the donor is not a Brazilian resident, the donee should pay the tax. This also applies if the donor and donee are not Brazilian residents, but the gift is located in Brazil.

iv Cross-border issues
In addition to estate and capital-gains related taxes, all investments and funds sent abroad are subject to taxation in Brazil. Revenues derived from financial investments, as the relevant interests, are taxed separately and are not considered in the annual tax return. Therefore, the taxpayer cannot use personal deductions (or losses in other financial investment) to reduce income tax. A taxpayer will pay income tax on a financial investment’s revenues at a rate that will not consider the global annual income and any deduction.

Revenues derived from abroad are also taxed in case of capital gain and on the progressive income tax table referred to in Section II.i.

Dividends received from a Brazilian entity are exempt, but dividends received from abroad are subject to taxation according to the progressive table.

As mentioned in Section II.ii, revenues from abroad are separated into two categories: amounts originally invested in reais and amounts originally invested in US dollars. All amounts originally invested in reais abroad are subject to exchange rate tax.

v Regulatory issues – the Brazilian Central Bank
Brazil has a Central Bank (BACEN), which controls all foreign exchange transactions performed therein. The negotiation of all types of currency is made directly by financial institutions that are authorised by the BACEN, which registers all funds remitted abroad.

The individual considered a Brazilian tax resident, who holds assets abroad, with a total market value of US$100,000 or higher as of 31 December of each year, is entitled to submit the Brazilian Central Bank Assets Information: no tax is due in view of this statement. Failure to provide the information requested by the BACEN may result in a penalty of up to 250,000 reais and the individual may also face criminal charges. If the total market value of assets abroad is higher than US$100 million, the Brazilian Central Bank Assets Information must be presented quarterly.

Furthermore, foreign nationals holding assets in Brazil must also register them with the BACEN. The foreign national must first request his or her individual or corporate taxpayer’s number (CPF or CNPJ, respectively) from the registry, after registering his or her personal information with the registry of individuals or companies in Brazil (CADEMP). As soon as the CPF of the individual or CNPJ of the entity is issued, all financial operations are ready to be performed. In the case of loans granted to individuals resident in Brazil, the applicable registry of the Brazilian Central Bank System (SISBACEN) is the Electronic Declaratory Registration and Financial Operations, while in the case of assets held in Brazil such as corporate stock, the relevant registry of the SISBACEN is the Foreign Direct Investment Registration System.
In the case of foreign individuals who die owning investments in Brazil, all heirs and successors thereof must have their own registries. In this case, the same CADEMP procedure shall be performed by each heir or successor. The change of registration of the investment in the case of death of the principal investor shall involve the simultaneous operations required by regulatory exchange control rules. These simultaneous operations require the issuance of foreign exchange agreements; however, they do not involve the effective liquidation of resources, since there is no issuance of payment order from abroad and the delivery of the coin is ‘symbolic’ (symbolic foreign exchange transactions).

vi Fiscal obligations and taxes on succession

The estate of a deceased person is separately taxed in Brazil as a specific entity: as it is a universality of assets and obligations, it is liable for all relevant due taxes on any tax event.

All taxes due in view of Brazilian legislation until the date of death are met by the estate. If the estate has not yet been submitted to the probate proceedings, the relevant taxes are paid accordingly and as per the assets’ value. However, if the assets have already been probated, the legal representative for the deceased’s estate do not respond for the payment of the due taxes. In this case, the successors must request to the federal authorities the cancellation of the deceased’s individual taxpayer’s registry. The heirs are only responsible for the payment of all taxes due after the probate proceeding and division of the assets. Such responsibility is limited to the amount received from the estate by each heir.

It is important to bear in mind the risk of capital gain in the estate procedure after an individual dies. When property rights are transferred by means of probate proceeding, the assets, in general, are transferred by cost (acquisition value, as stated in the deceased’s tax return). However, there is also the option to re-evaluate the asset by market value (provided by authorised real estate agents). In this case, there may be a capital gain in comparison to the acquisition value that triggers capital gain taxes. The taxpayer is the estate (if still existent) or the heirs at a rate of 15 per cent.

III SUCESSION

i Introduction to succession in Brazil

In Brazil, individuals may dispose of their assets by means of a testament or by means of the legitimate succession, which is determined by law. However, Brazilian legislation determines that there is a portion of an individual’s inheritance that must be divided among its successors – the legitimate succession.

The legitimate succession determines that the first individuals to be considered in the succession line are the descendants, who compete with the surviving spouse (depending on the marital regime, as per Section III.ii). Subsequently, the next of kin in the succession line as per Brazilian legislation are the ascending relatives, who also compete with the spouse (if existent). The collateral relatives are the last kin to be included in the legitimate succession. As per Brazilian law, all such individuals are entitled to at least 50 per cent of the deceased’s assets.

The inheritance is shared between the deceased’s descendants and the spouse according to the number of heirs; the status of the spouse is the same as of the descendants. Therefore, if there is one spouse and three children, the inheritance shall be divided into four parts. It is important to note that all descendants participate in the inheritance – even adopted children or children born out of wedlock.
If there are no descendants, the ascendants (i.e., the parents) may compete with the surviving spouse for the inheritance. In this case, the surviving spouse may continue to live in the real property owned by the deceased that was used as their daily residency, as long as it is the sole property of such nature. The surviving spouse may only benefit from the inheritance if he or she was not divorced or separated from the deceased, either judicially or in fact for more than two years. Only if there are no descendants and ascendants may the surviving spouse solely benefit from the legacy.

The collateral relatives until the fourth degree (siblings, aunts or uncles, cousins, great-uncles or aunts) may benefit from an inheritance if there is no surviving spouse, descendants or ascendants. In this case, the closest degree of kinship of collateral relatives exclude the most distant ones, i.e., siblings take precedence over aunts and uncles in receiving the legacy.

**ii Marital regimes**

The most common marital regime is the partial communion of assets, by means of which all assets acquired after the date of marriage are common to both spouses – therefore, all assets acquired before the marriage are considered the individual property of each spouse.

However, if the spouses do not wish to accept the partial communion of assets regime, a prenuptial agreement shall be executed at the date of marriage. The first marital regime, in this case, is the universal communion of assets, when all current and previous assets acquired by the spouses are common to both. The second regime, that of the total separation of assets, determines that all current and future assets of the couple are considered the individual property of each spouse. This regime is mandatory if:

- one spouse is older than 70 years;
- all parties depend on judicial authorisation to wed;
- one of the spouses is a widow or widower with children from a deceased individual whose assets have not yet been settled;
- one of the spouses is a widow or widower to a marriage that was cancelled within 10 months of the deceased’s death;
- one of the spouses is divorced and the estate has not yet been settled; or
- the marriage is between the tutor, guardian or trustee of the other spouse.

Furthermore, a companion is considered by Brazilian law as a legitimate family member – the automatic marital regime for this institution is the partial division of assets. However, the parties may decide to adopt a different type of regime upon the execution of a companionship agreement.

Brazilian law now provides for same-sex marriage; in May 2017, the Superior Court extended the current inheritance procedures to include same-sex partnerships, which means that all companions (heterosexual or same-sex) may benefit from a spouse or partner’s inheritance in the event of death.

**iii Cross-border issues**

In Brazilian law, regardless of the nationality of an individual, the succession rights are governed by the law of the country in which the deceased was last domiciled. Hence, in the case of death of an individual whose last residence was established in Brazil, whether he or she
is not, in fact, of Brazilian nationality, his or her assets (whether located in Brazil or abroad) will be divided among the successors according to Brazilian law. This will be the case even if the successors are not resident in Brazil.

On the other hand, in the case of individuals resident outside of the country who hold assets in Brazil, the succession will be governed by the law of the deceased's last domicile. If the succession law of the deceased's country is not favourable to his or her Brazilian spouse or children, the latter may request the succession to be regulated by the Brazilian law.

Furthermore, the Brazilian judiciary has exclusive jurisdiction over the probate of all assets located in Brazil. In this sense, the Brazilian judge shall apply the relevant foreign law; if the assets are spread across multiple locations in Brazil, the competent judge will be the one where the majority of them are concentrated.

In recent years it has become very common for Brazilian individuals to protect their assets for many reasons, including from high taxes in Brazil. Several Brazilian individuals, while trying to protect their assets, set up several corporate and tax structures during their lifetime – such as limited liability companies, corporations, corporate structures established among family members, etc. The incorporation of companies that separate assets to be held by spouses, siblings and descendants is quite usual in Brazil.

However, common foreign structures, such as trusts, are not very common in Brazil, mainly because they are not often recognised, since Brazil has a civil law system. Since the incorporation of trusts involves the remittance of proceeds abroad and having a separate capital structure from Brazil, they are not often used by Brazilians, who usually prefer the most ordinary structures, such as local companies or even setting up smaller companies abroad.

Additionally, trusts are not recognised by civil law jurisdictions, such as Brazil and many other Latin American countries. Since the local legislation does not typify the trust structure, it becomes rather difficult to propose such structures to Brazilian individuals who have never had contact therewith. Brazilians are more comfortable with structures they are familiar with and tend to prefer foundations when considering asset protection.

Nevertheless, a foreign trust may be recognised by Brazilian courts when its existence does not conflict with Brazilian law inheritance principles, including legitimate succession (enforced heirship).

IV WEALTH STRUCTURING AND REGULATION

i Commonly used vehicles and tax regimes for wealth structuring

Private clients in Brazil are allowed to set up either domestic or international vehicles, such as companies or investment funds for wealth structuring.

The holding companies are the most common vehicle domestically used for property planning, for the following reasons:

a real estate contributions (as capital contributions) are not subject to a real estate transaction tax (ITBI);²

b distribution of dividends by Brazilian companies is tax-free;

² Real estate transactions are subject to a municipal tax (ITBI) at a rate of 2 per cent to 3 per cent, depending on the municipality where the real estate is located, with the exemption of its incorporation to the patrimony of a legal entity as its object is not real estate business.
it is possible to make contributions in kind to increase corporate capital with cost value. In this case the cost value will be equal to the declared values of an individual’s last income tax declaration, avoiding payments of taxes over the capital gain; it is possible to define succession agreements in the articles of association or by-laws of the holding company; and holding companies improve the governance of family businesses.\(^3\)

Another option for investments are the exclusive investment funds that are also a common domestic structure that private clients choose as an alternative to preserve the family heritage. Usually individuals are taxed only in the event of receiving amounts from the fund, whether income or capital gains for sale of quotas.\(^4\) However, when a fund is invested in fixed assets, individuals are taxed for the anticipated profit every six-month period, without any deduction (losses are not deducted from future tax payments).

Even in the wealthiest families in Brazil, it is quite common for individuals to make investments in a specific fund with the aim of insurance called VGBL (only offered by licensed financial institutions) as a practical solution for succession purposes that allows the individual to invest in the following circumstances:

- in the event of the investor’s death or incapacity, the resources are made available to the elected beneficiaries, either with prompt full payment or monthly payments, without incurring in a grace period or in legal and judicial costs;
- the beneficiaries may be changed at any time;
- the investment must be reported in the income tax declaration, but it is excluded from the investor’s assets;\(^5\) and
- investments in funds created with the aim of insurance, VGBLs and PGBLs,\(^6\) are taxed as payments from the fund. In the first instance tax is levied on income and in the second instance the total amount, including the amount invested, is taxed.

It is also usual for Brazilian private clients to create funds and companies outside the Brazilian jurisdiction, as wealth structuring vehicles to investments, since this kind of structure defers the Brazilian income tax while the assets remain outside Brazil.

In addition, those vehicles provide a way to access more sophisticated structures that are not legally recognised in Brazil.

### ii Legal and tax treatment for wealth structuring vehicles

With regard to wealth structuring and planning, high net worth Brazilian individuals are no different from individuals in other parts of the world. They share the same will to protect, preserve and enhance their wealth.

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3 For instance, succession disputes and assets verifications are very usual when individuals participate directly in family business.

4 The Brazilian Federal Administrative Court has recently issued a precedent confirming that the capital gains arriving from investment funds are only subject to taxation in the redemption of the investment, at a 15 per cent income tax rate (Precedent No. 2202-01.591).

5 There are Brazilian states improperly legislating that VGBL must compose the tax basis for inheritance taxes. Taxpayers challenged these law provisions with success in some cases.

6 A PGBL is used to reduce the income tax due on the annual tax return, because it is deducted from the total amount of taxes to be paid.
Notwithstanding, the Brazilian Constitution and laws derive from Roman law, the civil law model of absolute ownership, which represents a barrier to the existing structures such as trusts and other sophisticated arrangements that would provide the mechanism through which they could achieve such goals under Brazilian jurisdiction.

As a result of this legal non-recognition and, taking into account forced heirship rules in Brazil, trusts, funds and foundations incorporated outside Brazil are commonly used as wealth structuring and estate planning, thereby allowing greater flexibility in allocating assets and defining rights and obligations among the individual’s heirs.

Heretofore, and differently from other countries, Brazil did not adopt a full controlled foreign corporation regime. Profits earned by foreign corporations controlled by Brazilian individuals are not subject to Brazilian income tax until such profits are actually distributed and received inside the country.

Not so long ago, it was quite common for Brazilians investors to simply invest outside Brazil, in this manner obtaining a tax deferral, but also avoiding the reporting requirements. From now on, hiding foreign assets will be much more difficult, since Brazil has recently signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters during the signing ceremony held at the G20 Summit in Cannes, France, in November 2011 and also executed several tax information exchange agreements (TIEAs) that will start to exchange automatic tax information in 2018.

Nevertheless, by doing such wealth planning abroad, as per Section II.iv, if the sum of investment abroad is equivalent to US$100,000 or more, Brazilian individuals are obligated to report such assets to the BACEN.

Finally, all the foreign assets must be declared on an annual basis to the Brazilian Federal Revenue.

iii Anti-money laundering regime

As a result of several international conventions, such as the Vienna Convention, the Palermo Convention, the UN Convention against the Financing of Terrorism, the UN Convention against Corruption and the Financial Action Task Force 40+9 Recommendations, among others, the Anti-Money Laundering (AML) Regime Law No. 9,613/98 was created in Brazil, defining money laundering crimes in broader terms than in some other jurisdictions, setting out the legal and preventive measures, the system for reporting suspicious activities, and the procedures for international cooperation.

After the corruption scandal known as Mensalão, in 2005, that involved the purchase of congressional votes by the ruling political party in Brazil, several of the defendants had money laundering charges dropped owing to the fact that the Brazilian AML Law at the time required actual knowledge of the origin of the funds by the Brazilian authorities.

Because of that incident, in July 2012, an amendment to the AML Law was signed (Law No. 12,683/2012), changing the definition of money laundering as the concealment of proceeds of any crime or misdemeanour, no matter the graduation, also excluding the requirement of actual knowledge of the origin of the illicit fund.

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7 Brazil has signed eight TIEAs, accordingly to the Exchange of Tax Information Portal: http://eoi-tax.org/jurisdictions/BR#agreements.

8 It is required to report the market value of the foreign assets or, when it is not available, the net worth of the companies held outside the Brazilian jurisdiction.
The AML Law created an obligation for individuals and companies to keep internal controls, in the case of an eventual administrative inspection, of relevant transactions, to clarify the identification of clients and confirm if the transactions carried out are compatible with the net worth involved.

The AML Law has also created an obligation to report any suspicious information verified by any party in a transaction. All suspicious information, as determined by the AML Law, has to be reported to the Council for Financial Activities Control (COAF), a financial intelligence unit linked to the Ministry of Finance that is actively involved in international initiatives related to the prevention of money laundering and financing of terrorism.

The Complementary Law No. 105 signed in 2001 introduced new rules on bank secrecy and extended the access powers of the COAF. In addition, Law No. 10,701, signed in 2003, created a national register of bank accounts and provided the COAF with even more power to obtain information from third parties.

V OUTLOOK AND CONCLUSIONS

Despite the political crisis that began in March 2014 with Operation Car Wash, which implicated the highest levels of power in political and business corruption, Brazil has been trying to establish itself as a country with a suitable environment for the internationalisation of numerous Brazilian companies and also for the many foreign companies that have started to operate in the Brazilian market.

The several anticorruption measures and investigations taking place in the country show that such irresponsible behaviour is no longer accepted by the population.

Brazil offers an ideal opportunity for advisory professionals in wealth and succession planning to turn the focus to every different vehicle and structure that complies with the current rules.

It is also possible that Brazil will face some relevant reforms in its tax law regime to comply with the OECD rules, so that it keeps following the path to be among the countries with a solid environment for international investors.
I INTRODUCTION

The current Canadian wealth situation

The current Canadian political, economic and social environment in 2018 is a mix of good and bad news. The only constant is change, which is moving at a progressively fast pace, with unpredictable and often unnerving results, and there is a general sense of apprehension about the future. The good news, however, is that the economy is generally stable, markets are good, corporate profits are strong and unemployment is at one of its lowest levels ever.

For the wealth management industry, times have never been better. An increasing percentage of the big six banks’ revenues are now derived from wealth management, and the sector is experiencing strong income growth. Wealth management has an increasingly high profile among Canadians. One can barely surf the web, pick up a newspaper, watch TV or walk past an electronic billboard without seeing some aspect of wealth management services featured. More money than ever is being pumped into the area by financial institutions and select professional firms where consolidation is occurring.

On the legislative side, some aspects of the US tax reform have come as good news for Canadians with US connections. The increase in the US estate tax exclusion amount to US$11.2 million for 2018, indexed to inflation, means that exposure to US estate tax will impact only the wealthiest. However, this good news could be short lived owing to a sunset provision that provides that, unless there is further legislative action, after 31 December 2025 the exemption will revert back to the 2017 amount.

The Canadian government committed a major policy blunder in July 2017 when it introduced proposals and legislation aimed at what is termed unfair tax avoidance by business owners and shareholders of private corporations, including deferring tax and splitting income among family members, but backed down from the most egregious measures, much of which were ill-conceived and unworkable. One could say this climbdown was good news for the private wealth industry, but it has left a bad taste, and there are concerns as to what may still lie ahead.

More good news is that house prices are cooling and becoming more stable.

The bad news is that, at the time of writing, Canada’s unrivalled and long-standing good relationship with its largest trading partner is under attack and in jeopardy as a result of President Trump’s latest actions and pronouncements. If the North American Free Trade Agreement (NAFTA) is not renewed, it will be catastrophic for the Canadian economy, which relies heavily on trade with the United States.

1 Margaret R O’Sullivan is principal and Birute Luksenaitė and Emma Hamilton are associate lawyers at O’Sullivan Estate Lawyers LLP.
Agreement is terminated or severely compromised, resulting in a decline in Canada’s real domestic product, an increase in consumer prices, and job losses, it will be harmful to the Canadian economy. How can any business or individual expect to manage this risk?

Meanwhile, government and consumer debt levels are at an all-time high. Most unsettling is that a rift has begun to emerge in Canadian society, as millennials believe they cannot aspire to the economic affluence of their parents, and middle-earners are under increasing pressure to make ends meet. Further, some perceived the government’s actions as divisive when it proposed tax changes targeting business owners and shareholders of private corporations who the government claimed were not paying their fair share of tax and were abusing the system. But this approach backfired, as most businesses in Canada are small and are the largest component and backbone of the economy, who would have borne the brunt of the proposals, and are made up of middle-earners who have relied on an established tax policy of over 40 years to sustain their businesses, resulting in a policy U-turn. Nevertheless, as a result, a substantial blow has been dealt to every entrepreneurial business owner who now finds himself or herself in an environment where the entrepreneurial spirit is no longer hallowed, but instead treated punitively by officials in charge of government policy. It is certainly not a supportive and conducive environment to grow our economy and reward those who take risks.

Evidently, there is a sense of discordance and unease regarding these developments; but given the volatility and uncertainty of the world in 2018, there is equally potential for new opportunities arising.

Key factors in respect of private clients

Canada’s constitutional system is a federal one, with a clear division of powers between different levels of government. Its primary legal heritage for all provinces and territories, with the exception of Quebec, is based on English common law; Quebec’s is based on civil law.

From the private client perspective, Canada offers the stability of a highly developed legal and court system and charter-based human rights protections. Property law, including succession, is a matter of provincial jurisdiction. Many modern and innovative concepts affecting private clients have been pioneered or progressed ahead of other jurisdictions in Canadian law, including equalisation of property between spouses on marital breakdown and death in several Canadian provinces recognising marriage as an equal economic partnership, recognition of common law spouses’ and same-sex spouses’ property and support rights, and same-sex marriage.

Many Canadian jurisdictions have modern laws governing incapacity and substitute decision-making to take into account the need for a modern infrastructure to deal with an increasingly ageing population. Canada’s multiculturalism and relatively ‘open-door’ immigration policy, which is required to maintain positive population growth, expand the Canadian economy and is increasingly geared to attracting more entrepreneurs and skilled workers, have together created and contributed to a dynamic, sophisticated, diverse and innovative Canadian culture.
II TAX

i Personal taxation

Federal and provincial income tax
Canada taxes Canadian residents on their worldwide income from all sources, and non-residents on certain Canadian-source income, subject to international tax treaties. Income for Canadian tax purposes includes income from employment, business, property, 50 per cent of capital gains, and various other income sources, less certain deductions.

Canada is a federal state consisting of 10 provinces and three territories. The provinces and territories also tax income generally on the same basis as the federal government, except for Quebec, and increased federal tax applies to certain income not earned in a province or territory. Canadian tax is levied at graduated rates of up to approximately 54 per cent in combined federal and provincial rates on taxable income, less applicable tax credits.

Canada taxes non-residents on income earned in Canada, notably income from business or employment in Canada, and from certain taxable Canadian property, including Canadian real estate. A withholding tax of 25 per cent is deducted from certain income payable to non-residents, subject to international tax treaties that reduce the applicable rates.

Capital gains regime
Unlike most jurisdictions, Canada has no gift or inheritance tax. Instead, it levies taxes on capital gains. As of 2018, 50 per cent of capital gains are included in income upon actual disposition or deemed disposition. There is an exemption for capital gains on a principal residence and a lifetime exemption for capital gains on qualified small business corporation shares (C$848,252 in 2018) and on qualified farm or fishing property (C$1 million in 2018).

The basic tax unit is the individual. Limited opportunities exist for income splitting, including through the use of trusts. Tax on capital gains may be deferred on certain transfers of property, for example, between spouses, or on rollovers into private corporations in exchange for shares.

ii Developments relating to personal taxation

Provincial tax brackets for high earners
The combined provincial and federal tax rates for high earners in 2018 range from 44.5 per cent in Nunavut to 54 per cent in Nova Scotia. The highest tax rate in 2018 in Ontario is 53.53 per cent. In 2015, Alberta introduced graduated tax rates for taxpayers. Prior to the new rates, all Albertans paid tax based on a flat provincial tax rate of 10 per cent. As of 1 October 2015, the highest combined provincial and federal tax rate for Albertans has been 48 per cent.

2017 tax amendments in planning with private corporations
As part of the 2017 federal budget’s commitment to address what it termed unfair tax-planning strategies using private corporations, the federal government released a consultation paper called ‘Tax Planning Using Private Corporations’ and proposed legislation that addressed advantages that were not available to most Canadians, such as income ‘sprinkling’ to lower-tax rate family members using private corporations; accumulating earnings that had been taxed at a low tax rate inside private corporations; multiplying the lifetime capital gains exemption; and converting a private corporation’s regular income into capital gains to take advantage of the lower rate on capital gains. Owing to a strong reaction from Canadian small businesses and the professional community, the government significantly scaled back its 2017 proposals,
enacting only the income sprinkling and passive income proposals, but not the capital gains proposals, which would have made it more difficult for business owners and farmers to pass on their businesses to their children.

**Revised federal legislation on the taxation of trusts**

Certain estates and testamentary trusts are taxed at graduated rates applicable to individuals, while trusts established during a person’s lifetime are generally taxed at the top of marginal tax rates applicable to individuals. In 2016, graduated rates for certain estates and testamentary trusts were eliminated. Now, the top marginal rate is applied to testamentary trusts and certain estates. However, graduated rates will continue to be available to ‘graduated rate estates’ for 36 months and to certain testamentary trusts having disabled beneficiaries who are eligible for the federal disability tax credit. In addition, the taxation year end for testamentary trusts is now 31 December and testamentary trusts are required to make instalment payments of income tax.

**Residence of trusts for tax purposes**

The Supreme Court of Canada in 2012 clarified the law on the factual tax residence of a trust in *Fundy Settlement v. Canada.* The Supreme Court of Canada held that the residence of a trust is where the central management and control of the trust occurs, a significant change from the former focus on a trustee’s residence. *Discovery Trust v. Canada* was the first decision to apply the test that was articulated in *Fundy Settlement.* In *Discovery Trust,* the court held that the beneficiaries’ involvement in the administration of the trust did not result in the trust being resident in the province in which the beneficiaries resided, as the trustee still made all decisions with respect to the administration of the trust. Instead, the court held that the trust was resident in the province in which the trustee resided. The CRA’s position in determining the location of the central management and where control of a trust takes place includes a review of whether the control rests with the trustee or someone else.

In addition to factual residence, trusts may also be subject to statutory deemed residence rules for Canadian tax purposes. Trusts that are not factually resident in Canada may be deemed resident in Canada for certain tax purposes, including computing the trust’s income. Deemed residence may apply to a trust if it has a Canadian-resident contributor or beneficiary.

**New principal residence rules**

In the Canadian system, capital gains are subject to taxation, and arise on the disposition of capital property. The capital gain is the difference between the property’s adjusted cost base plus costs of disposal, and the proceeds of disposition. The adjusted cost is the actual cost of the property, subject to certain adjustments. Proceeds of disposition are, generally, the actual proceeds, but are subject to certain deeming provisions that will deem the proceeds to be equal to the fair market value of the property in respect of dispositions that are not at arm’s length. A property is exempt from taxation on capital gains in the years that it is designated a principal residence.

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3 *Discovery Trust v. Canada,* 2015 NLTD(G)86.
4 CRA, Income Tax Folio S6-F1-C1, Residence of a Trust or Estate, 24 November 2015.
As of 3 October 2016, both individuals and trusts must report the disposition of a principal residence and make a principal residence designation in the prescribed form and manner. The period in which the Canada Revenue Agency (CRA) can reassess beyond the normal reassessment period is indefinitely extended if the disposition of a property is not reported and a penalty applies for late filing. For dispositions on or after 3 October 2016, an individual who is a non-resident of Canada in the year of acquisition of a principal residence loses the bonus exemption year when calculating the principal residence exemption.

As of 2016, only certain eligible trusts may designate a property as a principal residence for any year of ownership after 2016. Eligible trusts include qualified disability trusts, alter ego trusts, spousal or common law partner trusts, joint spousal and joint common law partner trusts, and certain trusts for the exclusive benefit of the settlor during the settlor's lifetime. Eligible trusts also include ‘orphan’ trusts where: the settlor died before the start of the year; the eligible beneficiary is a minor child whose parents died before the start of the year and is a minor child of the settlor; and at least one beneficiary of the trust is a resident of Canada during the year and is a specified beneficiary of the trust for the year.

Non-resident speculation tax
To date, two Canadian provinces – Ontario and British Columbia – have enacted additional land transfer taxes that apply to foreign buyers. As of 21 April 2017, the Ontario government introduced a 15 per cent tax on the value of the consideration when a residential property in the Greater Golden Horseshoe area is purchased or acquired by individuals who are not citizens or permanent residents of Canada, foreign corporations, or taxable trustees of trusts involving foreign individual- or corporate trustees or beneficiaries. Residential property is defined as land that contains between one and six single family residences. The new Toronto non-resident speculation tax applies in addition to the generally applicable land transfer taxes payable on Toronto properties at rates of up to 5 per cent (2.5 per cent being the Ontario land transfer tax and an additional 2.5 per cent being the Toronto land transfer tax).

As of 2 August 2016, British Columbia enacted a similar 15 per cent property transfer tax payable by foreign individuals, corporations or taxable trustees (the Vancouver tax) in addition to the general property transfer tax of approximately 2.5 per cent on transfers of residential property located in the Metro Vancouver Regional District (the Vancouver District). The 2018 British Columbia budget introduced an increase to the Vancouver tax to 20 per cent, effective as of 21 February 2018, and a new annual speculation property tax was proposed, which will apply to Vancouver District properties at rates of up to 2 per cent of property value per year in addition to the general property tax that applies to all owners.

General anti-avoidance rule in respect of income tax
The Income Tax Act (the Tax Act) contains a general anti-avoidance rule (GAAR), which may be applied to deny a tax benefit otherwise available under the Tax Act where certain conditions are met. In considering whether the GAAR applies, a court will generally consider whether there was a tax benefit, whether the transaction (or series of transactions) giving rise to the tax benefit was an ‘avoidance transaction’ and whether the avoidance transaction giving rise to the tax benefit was abusive.

Whistle-blower rules, audit initiatives and compliance measures
The CRA has launched the Offshore Tax Informant Program, under which the CRA will enter into a contract to provide financial compensation to individuals who provide
information that leads to the assessment and collection of additional federal taxes in excess of C$100,000, provided all recourse rights associated with the assessment have expired and where the non-compliant activity involves property located outside Canada or certain other foreign elements. Banks and other financial intermediaries are required to report international electronic funds transfers of C$10,000 and over, to the CRA. Such transfers are currently reported to Canada’s Financial Transactions and Reports Analysis Centre of Canada (FINTRAC). The CRA’s Related Party Initiative is ongoing, under which individuals, including high net worth individuals (generally, with over C$50 million) or those with complex planning using many related entities, have been asked to provide detailed information and supporting documents about Canadian and foreign interests. Thresholds relating to value and complexity have been relaxed, and individuals not under audit are also being asked for such information. An aggressive tax planning reporting regime generally requires advisers to report to the CRA information concerning certain transactions on Form RC312 by 30 June of the following year. Reportable transactions or a reportable series of transactions will generally include an avoidance transaction or series of transactions for the purposes of GAAR if they feature two of the following: contingent fees, confidentiality protection or contractual protection. Where the form is not filed, the denial of tax benefits and possible penalties may result.

iii Cross-border structuring

Immigration to Canada

Canada relies heavily on immigration and offers certain tax concessions to immigrants. These same concessions, along with the lack of gift and inheritance tax, make Canada an attractive destination. Upon immigration to Canada, an individual receives a ‘step up’ in the tax cost of his or her capital property (excluding taxable Canadian property), which eliminates Canadian tax liability for capital gains accrued to that point. In some cases, it may be possible to transfer a foreign-registered pension plan into a Canadian-registered retirement savings plan on a tax-free basis.

Non-resident trusts and immigration trusts

Certain non-resident trusts established by non-resident settlors, provided various conditions are met, may be exempt from Canadian taxes and can distribute trust capital to Canadian-resident beneficiaries tax-free, which provides tax planning opportunities where a non-resident’s trust is situated in a low-tax jurisdiction. However, the opportunities for trust planning with non-resident trusts have been significantly curtailed by the revised Section 94 of the Tax Act, which deems certain trusts with Canadian-resident contributors or Canadian-resident beneficiaries to be Canadian resident and taxable on their worldwide income. Where a trust is deemed to be Canadian resident, Canadian-resident contributors and beneficiaries may be liable for the trust’s Canadian income tax, along with the trust itself.

Previously, an immigration trust could be set up to benefit an immigrant to Canada and his or her family, and the income and capital gains in the immigration trust could accrue tax-free for up to 60 months following immigration. If the trust was settled in a foreign jurisdiction (including a low-tax offshore jurisdiction) with foreign trustees who held the foreign investment assets, there could be significant tax savings depending on the applicable tax rates. However, this planning opportunity was unexpectedly eliminated as a result of the
2014 federal budget. Immigration trusts, including those established prior to the legislative changes, are now subject to Canadian tax on their worldwide income, and the 60-month exemption from the deemed residence rule is eliminated.

**Emigration from Canada**

A taxpayer emigrating from Canada must pay a departure tax, which taxes gains on his or her property accrued during his or her Canadian residency, subject to exceptions including for certain Canadian *situs* property and retirement plans. Payment of the departure tax may be deferred upon providing security to the CRA.

**Tax treaties**

Canada is party to many bilateral tax treaties, which in part aim to prevent double taxation of income. Among other benefits, Canada's tax treaties generally include tiebreaker rules for determining tax residency for treaty purposes and reduce the amount of withholding tax otherwise payable by taxpayers who are entitled to benefit under such treaties. Often, the withholding tax is reduced to 15 per cent from 25 per cent and in certain cases to zero per cent. Owing, however, to variations in the internal taxation laws of treaty nations, there can be mismatches in tax credits and timing that are not addressed in the treaties. In 2014, Canada ratified an intergovernmental agreement (IGA) relating to the US Foreign Account Tax Compliance Act (FATCA), a US law that imposes strict reporting requirements to the US taxing authority, including on financial institutions located in Canada. Canada has also agreed to implement the Organisation for Economic Co-operation and Development (OECD)'s Common Reporting Standard (CRS), which is based on FATCA. As of 1 July 2017, financial institutions located in Canada are subject to the CRS and are required to provide the CRA with certain information pertaining to accounts and account holders.

**Foreign investment entity and foreign trust rules**

Foreign trust rules designed to more effectively tax Canadian residents’ passive investment, including income arising through non-resident trusts, have been enacted, following numerous amendments to draft legislation over a protracted period. The non-resident trust rules deem a trust to be resident in Canada if there is a Canadian-resident contributor, broadly defined, or a Canadian-resident beneficiary, and require tax to be withheld on distributions from trusts deemed Canadian resident, subject to exceptions. An election may be made to treat a portion of the trust as non-resident that will not generally be taxable in Canada. New provisions for taxing offshore investment funds have also been enacted, along with transitional provisions for those who filed under proposed foreign investment entity rules that were never enacted. The 2018 federal budget proposed additional reporting requirements for certain non-resident trusts and draft legislation was released in August 2018. The proposed requirement is for these trusts to annually report the identities of all their settlors, trustees, beneficiaries and all persons who have the ability (either under the trust terms or as a result of related agreements) to exercise control over trustees’ decisions regarding the income or capital of the trust, such as protectors of a trust. The proposed reporting requirements will apply to 2021 and subsequent taxation years.

Canadian taxpayers holding specified foreign property outside Canada with a cost amount of C$100,000 or more, are required to provide more detailed information about such property on a revised Form T1135, foreign income verification statement, including names of the countries and institutions where assets are held, foreign income earned on
the assets, and a maximum cost amount of the assets in the year. If Form T1135 is filed late or contains certain errors or omissions, the normal reassessment period is extended for three years, and severe penalties apply for failure to file.

iv  Regulatory issues

Regulation of banking and related industries

A significant portion of Canada's private wealth services are highly concentrated in the hands of six major Canadian national banks. In 2017, Bloomberg Markets magazine ranked four Canadian banks among the world's top-10 strongest banks with US$100 billion or more of assets. No other country dominated the list as Canada did. Banking is federally regulated by the Office of the Superintendent of Financial Institutions Canada, while the related investment industry, trust companies and insurance firms are regulated both federally and provincially. Canada's major banks are strongly capitalised and tend to have relatively conservative lending policies compared to other banking institutions.

In 1986, the federal government began to eliminate the four pillars of Canadian finance: Canada's traditional regulatory separation between banks, trust companies, insurance companies and investment companies. Numerous acquisitions of investment firms and trust companies by the six largest Canadian banks followed. In 1998, the proposed merger of two of the largest major Canadian banks was rejected by the federal government. In the past decade, Canada's major banks have expanded significantly into the United States. Canada's major banks offer an increasing array of services, including daily banking, investment services, financial planning and insurance, and wealth management, which tend to be fairly uniform among the banks.

For Canada, deregulation resulted in a flurry of mergers and acquisitions in the 1990s, leading to consolidation and the three largest insurance companies controlling about two-thirds of the domestic market.

v  Issues affecting holders of active business interests

Corporate taxation

Canada's tax environment includes low corporate taxes levied at flat rates. The rates have been declining for small businesses’ active business income between 2007 and 2017. The combined net federal and provincial corporate tax rates applicable to general corporations’ active business income in 2018 range between 10.5 and 31 per cent, and a similar rate applies to income that is not earned in a province.

Preferential tax treatment is offered to a 'small business corporation', which benefits from a reduced combined federal and provincial tax rate of between 10 and 22 per cent on the first C$450,000 to C$600,000 of its active business income. A small business corporation is a Canadian-controlled private corporation (CCPC) carrying on active business in Canada. The small business income limit is reduced on a straight-line basis for CCPCs that alone or as members of an associated group have taxable capital employed in Canada of between C$10 million and C$15 million in the previous year. Taxable capital is generally comprised of the corporation's retained earnings, surpluses and advances.

The 2018 federal budget proposed an additional means to reduce the small business deduction in the case of corporations that have more than C$50,000 per year of passive investment income. This proposal follows the 2017 taxation changes that target corporations that accumulate income that had benefited from the low small business tax rate. The 2018
Canada

The federal budget proposed to reduce the small business limit for CCPCs and associated corporations on a straight-line basis for CCPCs that earn between C$50,000 and C$150,000 of investment income such that the small business limit would be completely eliminated where a corporation earns C$150,000 of investment income per year. The new business limit reduction is expected to operate in reference to the business limit reduction for excess taxable capital, the effective reduction being the greater of the two. For this purpose, the 2018 federal budget proposed a definition of investment income or ‘adjusted aggregate investment income’ (AAII). Generally, AAII will exclude taxable capital gains from the sale of active investments and investment income that is incidental to the business. These exclusions are included for the purpose of protecting investment interests in Canadian innovation industry.

Shares of a small business corporation are eligible for a lifetime capital gains exemption of C$800,000 in total, indexed for inflation from 2014 (C$848,252 in 2018), as are certain qualified farm and fishing properties (capital gains exemption being C$1 million in 2018).

Investment income earned in a CCPC is taxed at very high rates. For instance, in 2018, CCPCs in Nova Scotia and Prince Edward Island will pay income taxes on their investment income at the rate of 54.67 per cent, which is higher than the highest individual tax rate in those same provinces (54 per cent and 51.37 per cent, respectively). In other provinces, CCPCs’ investment income is taxed at rates ranging between 50.67 per cent and 53.67 per cent. General corporations (non-CCPCs), who do not benefit from the small business deduction, pay taxes on their investment income at lower rates – at combined federal and provincial rates of up to 31 per cent in 2018.

For extracting corporate income by way of dividends, a gross-up, dividend tax credit (an enhanced tax credit in the case of dividends funded by the corporation’s active business income that did not benefit from the small business tax rate) and a corporate refundable tax mechanism (in the case of corporations that earn investment income) is provided to avoid double taxation of income earned in the corporation that is subsequently paid to its individual shareholders, who are taxed at their marginal tax rates.

The 2017 tax amendments made significant changes to shareholder taxation. The changes make dividends received by individual shareholders taxable at the top marginal rates (these provisions being called a ‘tax on split income’ (TOSI)), unless the shareholders receiving the dividends can show substantial labour or capital contributions to the operations of the business of the corporation. For example, TOSI will not apply to the business owner’s spouse aged 65 or older; shareholders over the age of 18 who make a substantial labour contribution to the corporation’s business of at least 20 hours per week; and shareholders over the age of 25 who own 10 per cent or more interest in the corporation that earns less than 90 per cent of its income from the provision of services. Those shareholders who do not meet these ‘bright line’ tests will face a ‘reasonableness’ test review by the CRA.

There are generally two kinds of dividends that can be paid to individual shareholders of CCPCs: eligible and non-eligible dividends. Generally, eligible dividends are funded by the corporation’s income that did not benefit from the small business tax rate. Eligible and non-eligible dividends are taxed at different rates in the hands of individual shareholders. For instance, in 2018 in Ontario, the highest individual tax rate on eligible dividends is about 39 per cent and that on non-eligible dividends is approximately 47 per cent. As part of the current tax integration rules, when a corporation pays a dividend to its shareholders, it may be able to receive a tax refund that is based on the corporation’s notional refundable dividend tax on hand (RDTOH) account, which is calculated in reference to the corporation’s investment income. The 2018 federal budget proposed to limit CCPCs’ access to the RDTOH refund
to the payment of non-eligible dividends, with an exception for that portion of the RDTOH that arises from the corporation's eligible portfolio income, which is proposed in the budget to be calculated as a new 'eligible RDTOH'. An existing RDTOH account will be redefined as 'non-eligible RDTOH' and it is proposed that companies will only be able to obtain refunds from the non-eligible RDTOH account upon the payment of non-eligible dividends, and a full refund from the non-eligible RDTOH account will need to be issued before a refund from the eligible RDTOH account can be accessed.

A tax-deferred transfer or rollover of certain eligible property to a taxable Canadian corporation for consideration, which must include shares of the corporation, is available, subject to certain conditions. The corporation may retain the shareholder's tax cost of the property or may elect a higher tax cost, within limits. Among other results, the corporation then assumes the tax liability relating to gains on the property, the payment of which is deferred to a later date.

**Goods and services tax, provincial sales tax and harmonised sales tax**

Federally, Canada levies a 5 per cent supply-side tax on most services and goods, including those made in Canada and imported, and certain property. The goods and services tax (GST) applies at all stages of production, subject to an input tax credit for tax paid at an earlier stage, and businesses are responsible for collecting and remitting the tax. The provinces and territories levy their own sales tax in addition to the GST. Five provinces have harmonised the GST with the provincial sales tax and this is known as harmonised sales tax. Combined, these taxes range from 5 per cent (in Alberta, Northwest Territories, Nunavut and Yukon) to 15 per cent (New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island).

### III SUCESSION

#### i Overview of succession in Canada

**Provincial and territorial jurisdiction**

In Canada, succession to property on death is generally a matter within the jurisdiction of the provinces and territories. Of Canada's 10 provinces and three territories, 12 are governed under common law, and one – the province of Quebec – under civil law. With respect to aboriginal Canadians who are subject to the Indian Act, succession to property on death falls within the jurisdiction of the federal government. Certain First Nations, however, have entered into self-government agreements that permit enactment of individualised laws, including those that relate to succession. These two latter scenarios are beyond the scope of this chapter.

**Conflicts of laws**

With regard to determining the applicable law, the law governing succession to movables is generally that of the testator's domicile and the law governing succession to immovables, typically the jurisdiction where the property is located. Formal validity, which includes such matters as execution requirements for a will, is determined by conflicts of law principles (and in respect of succession to movables is also generally that of the testator's domicile at date of death and in respect of succession to immovables is typically the jurisdiction where the property is located), and in several provinces has been expanded by statute.
For clients with certain connections to both Canada and a participating EU Member State, it is important to consider the impact of the EU Succession Regulation (Regulation (EU) No. 650/2012), which is, in effect, for deaths post 17 August 2015, including as it relates to a client’s ability to choose the law of his or her nationality to govern certain succession issues.

**Probate or equivalent court process**

The common law principle of testamentary freedom is the general rule in Canadian succession law, as modified by contract or legislation. After the testator’s death, a will is typically submitted to probate or equivalent court process, whereby it is validated and the executors’ appointment as legal representatives confirmed. In this process, the will and supporting documents, which may include a detailed asset listing, become public. Probate fees are typically levied in the form of a flat fee, or tax based on a percentage of estate assets (e.g., approximately 1.5 per cent in Ontario). In some provinces, in particular those with a high rate structure to probate a will, the option of creating a second, non-probate will that governs private company shares and other assets that do not require a court grant of probate to administer is often used to minimise probate fees and tax. A Quebec notarial will need not be submitted to probate in that province.

Once probate has been granted, the resulting certificate, grant or other like document is used by the personal representative to deal with third-party institutions and entities in the process of transferring title to the personal representative and gathering in the assets.

**Legislative provisions for succession on intestacy**

In an event of intestacy, each province and territory provides for a scheme of property division: typically between the testator’s surviving spouse and children – if any – failing which to other relatives as specified. Some provinces allocate the spouse a preferential share prior to dividing the estate between spouse and children. In this context, spouses are married spouses, including same-sex married spouses and, in some provinces and two territories, *de facto* spouses, providing certain conditions are met. A court process for letters of administration or equivalent provides for the appointment of estate trustees on intestacy.

As of 1 January 2017, under Part III of the Succession Law Reform Act in Ontario, Section 47(1) was amended to state that for the purposes of determining the beneficiaries on intestacy, the deceased’s descendants and relatives conceived and born alive after the deceased’s date of death shall inherit as if they were born during the deceased’s lifetime and survived, provided specific statutory conditions are met.  

**Legislative provisions for dependants’ support**

In all provinces, a dependant can claim support from the deceased’s estate, provided he or she stands in a certain relationship with the deceased (typically including a spouse, *de facto* spouse or minor child) and the deceased was providing him or her with support or had a support obligation at the time of death. The quantum of support is determined circumstantially and with judicial discretion, usually taking into account needs and means, and in some cases, the

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6 Ibid, see Section 1.1(1).
7 See, for example, *Bath v. Bath Estate*, 2016 BCSC 1239.
dependant’s accustomed standard of living.\(^8\) Some provinces recognise a moral entitlement to share in a deceased’s estate and will vary the distribution in a will or award support on this basis.\(^9\) Recent decisions have also shown that support may be awarded to a dependant in spite of an existing domestic contract if its terms have become unfair with the passage of time.\(^10\)

In Canada, it appears that cases involving entitlement to support in modern ‘non-traditional’ relationships (usually involving *de facto* spouses) are on the rise, including in recent decisions in Alberta\(^11\) and British Columbia.\(^12\)

**Legislative provisions for matrimonial property rights on death**

Property law in Canada falls under the jurisdiction of the provinces and territories; thus the availability and scheme of statutory property division claims by surviving spouses upon death of a spouse vary throughout Canada. The matrimonial property regimes of most provinces and territories provide a surviving spouse with property rights on a first spouse’s death. For example, in Ontario, a surviving spouse has a right to elect to claim against the deceased spouse’s estate to notionally equalise the property acquired during marriage as between the two of them. If such an equalisation claim is made, he or she thereby loses entitlements, if any, under the deceased spouse’s will and to certain other benefits. In New Brunswick, Newfoundland and Labrador, Ontario and Quebec, claims for division of property on death of a spouse are available to legally married spouses only as well as, in the case of Quebec, the survivor of a couple who have entered into a civil union. Currently, in British Columbia, Alberta, Prince Edward Island and the Yukon, death does not trigger a statutory property claim for the surviving spouse. All other provinces and territories provide a statutory claim to division of property on death and extend its availability to surviving *de facto* spouses provided the specific requirements of the governing legislation have been met.

**ii Key legislative or case law changes affecting succession**

*Increased Ontario compliance to probate a will*

In Ontario in 2011, legislative measures were enacted under the Estate Administration Tax Act permitting the Minister of Finance to assess estates for payment of additional Estate Administration Tax. No practical means or process for determining which estates to assess was put in place until 1 January 2015 when, with little forewarning, a new regulation under the Act came into effect. The changes usher in a new reporting regime that is triggered by applying for and receiving a certificate of appointment of estate trustee. Estate representatives must now, in addition to the paperwork relating to the certificate, provide an estate information return to the Ministry of Finance within 90 calendar days of the court issuing the certificate of appointment. Most significantly, the return (an approved form, which is available from the Ministry) requires detailed information about each estate asset and its fair market date of death value. The estate representative must be able to corroborate the reported asset values. Penalties include fines and even imprisonment for failing to file a return or where

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8 See, for example, *McKenna Estate (Re)*, 2015 ABQB 37; *Morassut v. Jaczynski*, 2015 ONSC 502.


10 See, for example, *McKenna Estate (Re)*, 2015 ABQB 37.


the information filed was false or misleading. Amending returns must be filed within 30 days of discovering a prior return was incorrect or incomplete, except where the value previously provided for an estate asset has been determined to be incorrect and more than four years have passed since the issuance of the certificate of appointment. The Ministry has broad audit powers in conducting its review of the returns, including assessment of further tax if the estate date of death value is determined to be higher than originally reported.

**Gifts in wills altered for public policy reasons**

Recent Canadian lower court decisions (one decision from New Brunswick and another from an Ontario court) had limited testamentary freedom by altering gifts in wills for public policy reasons. The New Brunswick decision of *McCorkill v. Streed* had the effect of striking an unconditional bequest to a racist corporation on the basis of public policy. This decision was upheld on appeal and an application for leave to appeal to the Supreme Court of Canada was dismissed. In the Ontario decision of *Spence v. BMO Trust Co*, a court struck the entire will of a testator who was survived by two adult daughters (neither of whom qualified as dependants) where one daughter was entirely left out of the distribution of the estate. The will stated the testator had excluded the daughter because she had not communicated with him for years. Based on affidavit evidence, however, the court concluded that the real reason for the daughter's exclusion was that she had had a child with a man of a different race. Again, the doctrine of public policy was employed and the entire will was struck down with the result that both daughters shared in the estate equally on intestacy. The Ontario Court of Appeal reversed the decision, thereby confirming in this instance that testators do not have any obligation to benefit persons who they have no legal obligation to support or otherwise benefit (e.g., non-dependent adult children).

**Mutual wills**

In a recent Ontario lower court decision, two spouses executed wills simultaneously leaving everything to the survivor of them, followed by an identical gift over to their four children (each spouse having two children from a prior marriage). After the husband's death, the wife made a new will and gifted her estate to her two adult children and she subsequently died. On an application commenced by the husband's two adult children, the court found that while there was not a direct written or oral agreement that the spouses' original wills were mutual wills, as a result of the extrinsic evidence presented – including with respect to the family context – an oral contract had existed between the spouses and by virtue of it, neither spouse was entitled to vary his or her will without the consent of the other spouse. The court held that the estate of the surviving spouse was to be divided between all four children. In a similar case, the testator and his wife executed wills without receiving legal advice. The testator left his entire estate to his wife and, if she predeceased him, the estate went to his two stepchildren. The wife died and two days later, the testator executed a will leaving his entire

14 *Canadian Association for Free Expression v. Streed et al.*, (2015), 9 ETR (4th) 203 (NBCA); CanLII 34017 (SCC).
15 *Spence v. BMO Trust Co*, 2015 ONSC 615.
16 *Spence Estate (Re)* 2016 ONCA 196, application to the Supreme Court of Canada for leave to appeal dismissed 2016 CanLII 34005.
estate to his biological children. The testator’s stepchildren brought an application regarding validity of the second will, questioning the capacity of the testator. However, the Court found no evidence or agreement to support the argument that mutual wills existed between the couple. The second will was valid.18

iii Cross-border developments

Changes to US transfer tax

Canada is home to many dual citizens, including US–Canadian citizens. Many Canadians own holiday, real or personal property in the United States, or spend significant time in the United States. A number of Canadians are, as a result, subject to the US transfer tax regime (US estate, gift, and generation-skipping transfer taxes) and are attentive to any changes related to it. Following the American Taxpayer Relief Act of 2012, which became law on 2 January 2013, the US exemption from estate tax was US$5 million, indexed for inflation (i.e., US$5.49 million for 2017) and the maximum rate of US estate tax increased from 35 per cent to 40 per cent, both permanently, subject to future legislation.

On 22 December 2017, President Donald Trump signed into law the Tax Cuts and Jobs Act, which temporarily doubles the federal estate and gift tax exemption from US$5.6 million to US$11.2 million for 2018, indexed for inflation. The increase is effective until 2025. Unless permanent legislation is enacted, the exemption will return to the pre-2018 regime in 2026. Where applicable, the US estate and gift tax exemption remains unified.

Income tax-related reporting requirements

FATCA, introduced to combat offshore tax evasion, will affect Canadians with US connections and Canadian financial institutions. Final regulations under FATCA set out detailed reporting and withholding requirements for non-US financial institutions with respect to accounts with certain US connections, including those beneficially owned by US citizens. Information to be reported includes identifying information, information about the values of the accounts, and transaction amounts. Other non-US entities (and certain Canadian trusts) are also required to report the ownership or beneficial interests of US citizens.

Under FATCA, such information is generally required to be provided directly to the US Internal Revenue Service (IRS) by non-US financial institutions and entities. Canada has ratified a Model 1 type IGA with the United States and passed legislation that aims to implement the IGA. Designed to ease compliance with FATCA, the IGA modifies FATCA’s provisions in respect of Canadian financial institutions and other Canadian entities, and expands the tax information exchange provisions between Canada and the United States. Pursuant to the IGA, Canadian financial institutions will generally report information to the CRA rather than directly to the IRS, although they are generally required to register with the IRS to obtain an identification number. It is intended that by complying with the IGA, Canadian financial institutions will avoid a 30 per cent withholding requirement under FATCA on certain payments to them. Also, certain Canadian-registered plans are exempt from reporting under the IGA, and local financial institutions may be entitled to additional relief.

A self-reporting scheme applies to US persons (including US citizens, green-card holders and certain persons who spend a substantial amount of time in the United States) in

18 Lavoie v. Trudel, 2016 ONSC 4141.
Canada


In June 2015, Canada signed the Multilateral Competent Authority Agreement (MCAA), which provides for a coordinated arrangement for the automatic exchange of financial account information among various countries. Under the MCAA, Canada agreed to implement the OECD’s CRS. As of 1 July 2017, financial institutions located in Canada are subject to the CRS and are required to provide the CRA with certain information pertaining to accounts and account holders. The first information exchanges will take place in 2018. The CRS is based on FATCA and is similar in effect.

United States income tax penalties for Canadian residents

The Canadian government has expressed its concern to the US authorities and certain concessions have been granted to Canadian residents who are dual citizens of Canada and the United States. The US IRS has provided measures to assist such persons to fulfil their filing and reporting obligations. In June 2014, the IRS announced streamlined filing compliance procedures for certain US taxpayers who non-wilfully failed to disclose offshore assets, eliminating former requirements that taxpayers owe US$1,500 or less per taxation year and a former risk questionnaire, and requiring a certification regarding the taxpayer’s non-wilful conduct. Certain penalties or enforcement actions may be avoided, and taxpayers may claim retroactive deferral of income earned in Canadian retirement plans. The IRS has announced it will end the 2014 Offshore Voluntary Disclosure Program in September 2018.

Uniform Substitute Decision-Making legislation

The Uniform Law Conference of Canada (ULCC) adopted the Uniform Interjurisdictional Recognition of Substitute Decision-Making Documents Act (Uniform Act) in August 2016. The Uniform Act is a joint project of the ULCC and the Uniform Law Commission of the United States (ULC), which was undertaken to promote cross-border portability and utility of substitute decision-making documents for property and personal care. The ULC adopted its version of the Uniform Act in July 2014 and US states may now consider enacting it internally. To date, Idaho, Connecticut and Alaska have enacted it. It is up to each Canadian province and territory to consider adopting and implementing the Uniform Act. This new uniform legislation in each jurisdiction marks a significant step forward in promoting cross-border effectiveness of powers of attorney.

Under the ULCC Uniform Act, which differs from the ULC one, a ‘substitute decision-making document’ will be formally valid if it complies with any of the following:

- the law indicated in the document;
- the law of the jurisdiction in which it was executed;
- the jurisdiction in which the individual was habitually resident; or
- the law of the place it is to be used.

In the Canadian Uniform Act, the application of the governing law can only be refused if its application would be manifestly contrary to the public policy of the enacting province or territory, which the notes to the Uniform Act indicate in matters relating to personal care, including specific medical procedures. The Uniform Acts provide for the ability of a third party to rely on a document as well as, subject to certain exceptions, the obligation
of third parties within a reasonable time to accept a substitute decision-making document and not require an additional or different form of authority. It also provides for a court order mandating acceptance and liability for legal costs for refusal to accept a substitute decision-making document in violation of each Uniform Act.

**Recognition of foreign trusts**

The Hague Convention of the Law Applicable to Trusts and on Their Recognition, adopted in 1984 by the Hague Conference on Private International Law, was ratified by Canada and for several years has been in force in the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, Saskatchewan, and, as of 12 February 2018, Ontario, meaning it is now in effect in all Canadian common law provinces.

### iv Applicable changes affecting personal property

#### Same-sex marriage and Quebec civil unions

In 2005, Canada legalised same-sex marriage and, as a result, a broad array of statutory and common law rights have been available to same-sex married spouses for over a decade, including rights to share in an estate upon intestacy and any rights to property division under provincial family law statutes. Quebec also solemnises a civil union for same-sex or opposite-sex couples, which confers similar rights to marriage.

#### Rights of de facto spouses

For unmarried *de facto* spouses Canada recognises a limited subset of legal rights. *De facto* spouses are treated similarly to married spouses for various purposes, including taxation and certain government benefits, but significant gaps remain in respect of property rights on relationship breakdown and death, although this varies by province and territory.

#### Spousal support provisions for de facto spouses in Quebec

In early 2013, the Supreme Court of Canada delivered its decision in *Quebec (Attorney General) v. A.*, also known as *Lola v. Eric*. Lola (not her real name) claimed spousal support and property rights from her billionaire *de facto* spouse Eric. The province of Quebec has a greater percentage of *de facto* spouses than any other province (approximately 32 per cent in 2011, with the national average being 16.7 per cent) and there are few legal rights provided to these spouses on relationship breakdown. While a majority of the Supreme Court agreed with the Quebec Court of Appeal in finding that Article 585 of the Quebec Civil Code, which does not provide spousal support for *de facto* spouses although it provides for support among married or civil union spouses, discriminates against *de facto* spouses on equality grounds, the discrimination is justified on the principle of respecting individual couples’ choice and autonomy.

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Common law property division for de facto spouses

In *Kerr v. Baranow* and *Vanasse v. Seguin*, the Supreme Court reviewed the principles of unjust enrichment and resulting trust applicable to *de facto* spouses on relationship breakdown. After a relationship of over 25 years, Ms Kerr claimed property and support entitlements. Both parties had worked and Mr Baranow had cared for Ms Kerr after she had suffered a stroke. The court reviewed the law of unjust enrichment applicable to *de facto* spouses not included in most provincial statutory property division schemes. The elements of the claim are enrichment of one spouse, the corresponding deprivation of another and absence of juristic reason (such as a contract), and remedies have included a constructive trust and monetary amounts, including amounts relating to value received. Where appropriate, the claimant should be treated as a co-venturer in a joint family venture and should share the couple’s mutual gains. Indicia of a joint family venture include mutual effort, economic integration, intention and priority to the family, and there must also be a link between the contribution and wealth accumulated. A new trial was ordered in *Kerr* regarding unjust enrichment. A monetary remedy is not limited to a value-received approach, and in *Vanasse*, the Supreme Court upheld a monetary award granted at trial to a partner who had cared for a young family and given up career opportunities during a 12-year relationship.

Discretionary trust interests as matrimonial property

British Columbia’s Family Law Act is the first Canadian family law statute to expressly address discretionary trust interests in the division of family property by categorising certain beneficial interests in property held in discretionary trusts as excluded property. Problems with the original wording of the Act have been rectified by amendments that came into force on 26 May 2014, thereby clarifying that only the increase in value of the spouse’s beneficial interest in a discretionary trust will be subject to division on separation (rather than the increase in value of all of the property in the trust, as originally drafted). Valuation of these interests on separation will continue to remain a live and litigious issue in this province and throughout Canada, as evidenced by reported decisions in Saskatchewan, Alberta and Ontario with relatively little valuation analyses having been reported to date.

Legal presumptions relating to jointly held personal property clarified and effect of transfer examined

In two companion cases, *Pecore v. Pecore* and *Madsen Estate v. Saylor*, the Supreme Court of Canada clarified the common-law presumptions of resulting trust and advancement, which are legal presumptions subject to being rebutted on the civil standard of proof. The Court clarified that a recipient of gratuitously transferred personal property is generally presumed to hold it on resulting trust for the donor. The presumption that the property so transferred is advanced to the donee that has historically applied to certain family relationships, applies to transfers between a parent and minor child (and not from parent to adult child). The Court also canvassed issues of evidence. In *Pecore*, the Court found that a father who had placed

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22 *Grose v. Grose*, 2015 SKCA 68.
financial accounts into joint names with his daughter had an actual intention to gift these, whereas in *Madsen* the opposite result prevailed. In *Bradford v. Lyell*, a Saskatchewan court held that if an *inter vivos* transfer of a condo property into joint ownership by a grandmother to her granddaughter was found to be intended as a gift of the right of survivorship at the time of the transfer, both the legal and equitable title vested when the joint title was created such that the gift was complete at that time and the grandmother could not later change her mind in her will, thereby entitling the granddaughter to the beneficial ownership of the property upon the grandmother’s death.

Joint ownership continues to be a legal minefield in the context of estates and estate planning. Two subsequent Ontario Court of Appeal decisions have added further outcomes to gratuitous transfers of property into joint ownership. In *Sawdon Estate v. Sawdon*, the court found that evidence of intention regarding the transfer may not only show that the presumption of resulting trust has been rebutted, but also that a transfer of personal property into joint names created a trust of the beneficial right of survivorship for certain beneficiaries in addition to the surviving joint owners (two of the deceased’s children) such that the property passed outside the deceased’s estate and was divided equally among all five of the deceased’s children. In *Mroz (Litigation guardian of) v. Mroz*, the Ontario Court of Appeal reviewed a mother’s transfer of her home into joint ownership with her daughter where the mother’s will directed that the proceeds of sale from the home be used to fund two legacies to her grandchildren. In this instance and based on the findings of the trial judge regarding the mother’s intentions at the time of the transfer, the Court held that the daughter had not rebutted the presumption of resulting trust, held the property as trustee and the property was to be dealt with in accordance with her mother’s will. *Mroz* was distinguished from *Sawdon* given that the trust obligation in *Sawdon* arose at the time of the transfer (it was *inter vivos*) and in *Mroz* the trust obligation was not to arise until after the mother’s death. In other words, it would appear from these two decisions that trust obligations must take effect prior to a joint owner’s death for the result in *Sawdon* to occur.

In Ontario, the Court of Appeal in *Andrade v. Andrade*, found that the presumption of resulting trust applied where a mother purchased a property using funds provided to her by her children who lived in the home with her, which were applied to the down payment, mortgage and expenses, but the property was held in the names of two of her seven adult children at any given time. The court indicated that the trial judge had erred in finding that the mother had not contributed any of her own funds to the home, and that once her children had provided funds to their mother, the funds became hers. The court also noted that while the tax treatment of the asset post-transfer is one factor to be considered in determining intention at the time of a transfer of a property (in this case, units in the home had been rented out to third parties over the years and the title-holders had reported the rental income on their returns, while their mother had actually received the rent), but it is not determinative of the transferor’s intention. Adding a further dimension to the presumption of resulting trust, a 2015 Alberta Queen’s Bench decision considered, among other matters, whether the presumption applies when a person designates a beneficiary of a retirement plan.

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29 2015 ONCA 171.
30 *Andrade v. Andrade*, 2016 ONCA 368.
(or other financial products capable of being designated).\textsuperscript{31} The judge ultimately avoided deciding the issue by finding evidence of the deceased’s intention on a balance of probabilities to gift the retirement plans proceeds to his son as the named beneficiary, leaving the question open for future judicial determination.

In Quebec, there is no equivalence to joint tenancy or rights of survivorship. In \textit{Gauthier v. Gauthier},\textsuperscript{32} the deceased and his son signed an account opening agreement in Florida that held the deceased’s inheritance. The will named the deceased’s three children as beneficiaries, but the son submitted that the account agreement left the inheritance to him, or in the alternative, his father intended to gift the account. The Court did not apply \textit{Pecore}, but rather looked to the deceased’s intentions. The Court held that the deceased did not intend to gift the account.

Most recently, in the British Columbia Court of Appeal decision in \textit{McKendry v. McKendry},\textsuperscript{33} the deceased transferred property into joint tenancy with her son and executed a trust declaration to support her intention that the property was to be held in trust. The deceased later decided to gift the property to her son. The deceased executed a two-page document drafted by her lawyer and revised her will to include a clause outlining that the property was to be a gift. The trial court held that the property was held in trust for the deceased by the son and an executed deed would have perfected the gift, but the Court of Appeal found the deceased’s intentions to be ‘manifest and unambiguous’ in providing an \textit{inter vivos} gift to her son. The presumption of resulting trust was not considered in this case. This decision highlights the importance of providing clear evidence of intention, whether that is through a third party or supporting documentation.

\textbf{Legal presumption of advancement as between spouses in BC}

In \textit{F(VJ) v. W(SK)},\textsuperscript{34} the British Columbia Court of Appeal confirmed the common law presumption of advancement between spouses was not abolished by the enactment of that province’s new Family Law Act\textsuperscript{35} in 2011, and noted that a BC statute contained no express provision altering the impact of or abolishing the presumption as was the case in the family law statutes of other Canadian jurisdictions such as Alberta, Saskatchewan and Ontario. However, in \textit{HCF v. DTF},\textsuperscript{36} the British Columbia Superior Court made a compelling finding that the presumption of advancement is an outdated concept and cannot co-exist with the property division scheme under the Family Law Act. The Court held that the husband who owned excluded property was able to retain that exclusion on separation notwithstanding that he gifted it to his wife. The law in this area is far from settled and will be challenged as the decision is currently under appeal to the British Columbia Court of Appeal.

\textbf{Exempting certain matrimonial property from the equalisation regime}

The 2012 Ontario Court of Appeal decision in \textit{Spencer v. Riesberry}\textsuperscript{37} held that in the circumstances, a matrimonial property held by a family trust where one of the beneficiaries

\textsuperscript{31} \textit{Morrison Estate (Re)}, 2015 ABQB 769.
\textsuperscript{32} 2016 QCCS 2333.
\textsuperscript{33} 2017 BCCA 48; similar decision by the Ontario Court of Appeal in \textit{Laski v. Laski}, 2016 ONCA 337.
\textsuperscript{34} 2016 BCCA 186 (appeal dismissed with costs).
\textsuperscript{35} SBC 2011, c.25.
\textsuperscript{36} 2017 BCSC 1226 (currently under appeal).
\textsuperscript{37} \textit{Spencer v. Riesberry}, 2012 ONCA 418.
resided did not qualify as a matrimonial home for the purposes of Ontario’s Family Law Act and excluded it from the equalisation calculation as the beneficiary in question did not have an ‘interest’ in the property within the meaning of the Act (although the value of the interest in the trust was still included for the purposes of the calculation). This case represents a frustration of the matrimonial home protection contained in the Act, as well as a potential circumvention of the usual requirements for the spouse’s consent on the sale or encumbrance of a matrimonial home and the right of possession for the non-titled spouse.

**Proprietary estoppel**

The equitable claim of proprietary estoppel has been successfully used in two recent Ontario cases as the basis for a cause of action in respect of an unfulfilled or reneged promise or assurance relating to a cottage property. In both *Clarke v. Johnson* and *Love v. Schumacher*, the equity resulted in the appropriate remedy being, based on the facts and the exercise of judicial discretion, a proprietary one in the form of an exclusive, irrevocable and time-specific licence (as a monetary award was found in both instances to be inappropriate or insufficient). In both decisions, the courts followed the modern UK test to establish proprietary estoppel, being the establishment of three criteria:

- **a** encouragement or acquiescence in respect of land;
- **b** detrimental reliance; and
- **c** unconscionability.

A third case arising in British Columbia, resulting in a successful proprietary estoppel claim involving a horse farm that saw the trial judge award the entire horse farm to the applicant, has been remitted back to the trial judge to assess the outstanding claims of unjust enrichment and express or implied trust, as well as the proportionality of the trial judge’s remedy to the proprietary estoppel claim. An application for leave to appeal this decision was recently dismissed by the Supreme Court of Canada. *Cowper-Smith v. Morgan* is a British Columbia appellate court decision in which the proprietary estoppel claim was unsuccessful as the person against whom the claim was advanced did not own the property in question at the time the assurance or representation was made. On appeal to the Supreme Court of Canada, the Court’s ruling clarified the test for proprietary estoppel and expanded its scope. The British Columbia appellate court decision was overturned and the Court found that proprietary estoppel had been established by the appellants. The Court found that reliance on an expectation to enjoy a right or benefit over a property, even without an interest in such property, is reasonable.

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41 2016 BCCA 200 (overturned).
IV WEALTH STRUCTURING AND REGULATION

i Common vehicles for wealth structuring

Trusts and holding companies are perhaps two of the most common vehicles used in wealth structuring.

**Trusts**

**Income splitting**

Trusts can be established *inter vivos* or by will. *Inter vivos* trusts are often used to split income with family members, where the trust earns income and acts as a conduit to allocate income, including taxable capital gains, among beneficiaries who are subject to lower rates. Effective planning involves careful attention to the possible application of the attribution rules, which can attribute income back to a high-tax rate taxpayer.

**Trusts used in conjunction with an ‘estate freeze’**

Trusts are also commonly used in conjunction with an estate freeze to hold growth property for future generations, such as common shares of a private company which are expected to grow in value, and thereby defer taxation on any gains until the future rather than until the death of the founder. This can achieve significant tax savings. The use of a trust can allow for control of the timing of distribution of property, for selection of beneficiaries and for general wealth protection purposes. Generally, a fully discretionary trust is used for such purposes.

**Trusts as will substitutes**

Trusts are also increasingly used as will substitutes, in particular ‘alter ego’ and ‘joint partner’ trusts that are specifically defined under Canadian income tax legislation and allow persons aged 65 and over, provided certain conditions are met, to roll over capital property on a tax-deferred basis, as opposed to triggering capital gains. Alter ego and joint partner trusts are often used to provide for succession to property on the death of the spouse(s) as a substitute to a will. They may offer benefits such as:

- avoiding expensive court fees, probate taxes and the protracted court probate process;
- more privacy than a will;
- ensuring capital succession to property on death; and
- protection against estate litigation, including will challenges and other claims arising on death.

Trusts may also offer an effective and sophisticated vehicle to manage assets on incapacity as a primary alternative to a power of attorney.

**Use of testamentary trusts for income splitting and other benefits**

Testamentary trusts (trusts created under a will) have been used to provide for income splitting after the testator’s death. Certain estates and testamentary trusts are taxed at the graduated rates applicable to individuals, whereas trusts established during lifetime are subject to the top marginal tax rates applicable to individuals. Prior to 2016, testamentary trusts allowed for income splitting between the trust and one or more beneficiaries, which resulted in significant tax savings. However, commencing in 2016, testamentary trusts are subject to the top tax rate applicable to individuals and, consequently, the above tax benefits have been eliminated, although it will still be possible to ‘sprinkle’ income among a group of
beneficiaries of a discretionary testamentary trust if the trust terms permit. Also, the use of a testamentary trust may provide for capital succession planning and can safeguard against beneficiaries’ matrimonial and creditor claims, among other benefits.

**Multiple wills used to minimise probate fees**

Multiple wills are increasingly used in certain provinces in order to minimise estate administration tax and probate fees. For example, in Ontario, estate administration tax is approximately 1.5 per cent of the value of estate assets. Assets are often segregated under two wills: a primary will and a secondary will. Assets that generally do not require a probated will to administer by way of proof of executors’ authority to third parties, such as financial institutions and purchasers of land property, are segregated under a secondary will. The secondary will would typically include private company shares, family loans, tangible personal property and beneficial trust interests. Only the primary will is typically probated, and applicable tax or court fees are then based on the value of the assets passing under the primary will, which is generally expected to be a more modest asset value base.

**Holding companies**

Holding companies are a common feature of Canadian estate planning. They are often used to hold investment assets, including US securities and certain other US situs assets to protect against exposure to US estate tax, to defer tax on active business income where shares of an active business are held by the holding company, to split income, including in conjunction with use of a family trust, for asset protection and retirement planning.

**Potential tax advantages of holding companies**

The utility of an investment holding company to earn investment income at a lower tax rate than if earned personally will depend on changing tax rates, which historically have at certain times offered tax advantages and at other times are neutral and less advantageous.

Holding companies are also used in conjunction with probate fee and estate tax minimisation strategies as outlined above. Private company shares can pass under a secondary will, which typically may not need to be probated, thereby saving fees and tax, which can be significant where the shares have a high value. There is potential for double taxation on death where assets are held in a holding company, since a deceased person will be subject to personal taxation on the deemed disposition of the shares of the holding company giving rise to possible taxable capital gains, and also the same gains may be reflected in the holding company’s underlying assets, on which tax will be paid at the corporate level on sale of the assets or wind-up of the company. It is therefore necessary to implement proper post mortem tax planning to avoid potential double taxation on death.

**Anti-money laundering regime**

The Proceeds of Crime (Money Laundering) and Terrorist Financing Act came into effect in 2001. It introduced requirements for a compliance regime, record-keeping, client identification and reporting. Reporting entities must implement a compliance regime, keep certain records, obtain certain client identification and report suspicious transactions to an independent agency, the FINTRAC. Certain other financial transactions, as well as terrorist property, must also be reported. Reporting entities include financial institutions, such as banks, trust companies, loan companies, life insurance companies, brokers and

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agents, securities dealers, accountants and accounting firms carrying out certain transactions, real estate brokers, and certain others. The legislation imposes harsh financial and criminal penalties, including imprisonment for failure to report. Reporting entities have to send large cash transaction reports to FINTRAC when they receive an amount of C$10,000 or more in cash in the course of a single transaction, and financial entities, money service businesses and casinos have to report incoming and outgoing international electronic funds transfers of C$10,000 or more in a single transaction.

V OUTLOOK AND CONCLUSIONS

Hopefully, a year from now, our worst fears regarding the Canadian outlook will have come to naught, but the current trajectory points to more uncertainty and turbulence, and an increasingly high-tax environment, allowing less opportunity and scope for tax planning. Perhaps the silver lining in this dark cloud is that there is a renewed focus on ‘core’ wealth management and tax planning, and a more balanced, holistic, long-term and values-based approach to private wealth. We can only hope.

With demographic change and trillions of dollars yet to be transferred intergenerationally, there is the possibility for new ideas and opportunities, which bodes well for the private client adviser.
Chapter 13

CAYMAN ISLANDS

Alan Milgate1

I INTRODUCTION

The Cayman Islands is a British Overseas Territory located in the western Caribbean. The jurisdiction is recognised as a major international financial centre with leadership in a number of areas, including the offshore trust industry.

Private and institutional users are attracted to the Cayman Islands because of its network of top qualified global advisers, professional and efficient infrastructure, business-friendly approach, adaptability, English common-law framework, economic and political stability, effective regulation and tax neutrality.

The law in the Cayman Islands is derived from an amalgamation of common law and equity, English statutes and local statutes. Trust legislation is supported by a strong and highly regarded local and independent judiciary, court system and legal community. Public and private sectors are continuously reviewing and updating key legislation so that it remains current, viable and relevant in a global context, and also creating new legislation to meet ongoing needs.

In addition to traditional private wealth planning, Cayman Islands trusts and companies are used extensively in corporate structuring, capital markets transactions and structured finance deals. The Special Trusts Alternative Regime (STAR) developed in 1997, created an innovative trust-planning opportunity, providing for trusts to be established for any purpose, provided it is lawful and not against public policy. Advocates of STAR continue to find new uses for this regime in their planning.

The Banks and Trust Companies Law (2013 Revision) and the Private Trust Companies Regulations (2013 Revision) give the Cayman Islands Monetary Authority (CIMA) the responsibility of regulating the trust industry in the Cayman Islands. This includes licensing, registration and ongoing supervision and is a critical feature in the context of a continued focus on compliance in the finance world. CIMA strives to remain first-in-class through ongoing investment in top-quality staff and education and through its collaboration with the private sector in understanding how to meet the needs of Cayman Islands products while upholding the swiftly increasing global standard required of proper regulation.

The Cayman Islands continues to play a leading role in the fight against illegal activities and tax evasion to maintain its position as a premier global financial centre. The jurisdiction takes pride in its forward-thinking, cooperative and dynamic attitude, which saw it counted as one of the first countries (referred to as the ‘Early Adopter Group’) that have implemented

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1 Alan Milgate is a partner at Rawlinson & Hunter.
the automatic exchange of information exchanges under the Common Reporting Standard (CRS) by September 2017 and leads the way with a comprehensive and sophisticated approach to other global transparency measures.

II TAX

The Cayman Islands is a tax-neutral jurisdiction. There has never been direct taxation in the Cayman Islands either on individuals or corporations and the only fiscal impositions are stamp duty and import duty. The Cayman Islands has no corporation tax, income tax, capital gains tax, inheritance tax, gift tax, wealth tax or any other direct tax.

An exempted company, one whose objects are to be carried out mainly outside the Cayman Islands, can be granted a renewable 20-year guarantee that it will not be subjected to taxation. This is an additional comfort for users of the jurisdiction, even though there are presently no taxes in the Cayman Islands. A trust can also be registered as an ‘exempted trust’ and obtain an undertaking that exempts the trust from the risk of future taxation for 50 years.

III SUCCESSION

The Cayman Islands adopts the concept of freedom of testamentary disposition. This sets it apart from most civil law jurisdictions where there are forced heirship rules. In the Cayman Islands, there is no obligation on death to provide for any specified persons and no obligation to maintain dependants.

The Cayman Islands is also bound by the conflict of laws rules in England. Under conflict of laws rules, immovable property in an estate will be determined by the laws of the country in which the immovable property is located. Therefore, the Cayman Islands succession law will apply to any immovable property located in the Cayman Islands. Conflict of laws rules further provide that succession of movable property is governed by the law of the deceased’s last domicile. Therefore, where a foreign-domiciled person leaves a will disposing of movable property located in the Cayman Islands, the will is only valid to the extent that it is valid under the laws of the deceased’s last domicile.

It is the responsibility of the deceased’s personal representatives to ensure that the estate is dealt with in accordance with the law. The personal representative will apply to the Civil Registry Probate Section of the Grand Court Registry in the Cayman Islands for a grant of representation that serves as proof that the person named within is entitled to collect and distribute the estate. A grant of probate is issued where a will is left by the deceased and the will is proven to the satisfaction of a judge to be valid. A grant of letters of administration will be issued by a judge where no valid will has been left.

Foreign grants of representation from foreign courts in respect of the estates of persons who died domiciled outside the Cayman Islands, leaving assets or property within the Islands, can be resealed by the Grand Court in the Cayman Islands. Once resealed, the grant will be valid under Cayman Islands law. Generally, this process is not available where the deceased dies domiciled in a civil law country as grants of probate are unique to common law.

Applications for a grant of representation must be made within six months of the date of death of the deceased. In the event of failure to do so, leave of the Court must be obtained before an application can be made.
Where the assets of the deceased are held within a Cayman Islands trust structure, it is unusual for a grant of representation to be required in the Cayman Islands to access those assets. This is one of the significant benefits of using a Cayman Islands trust to own Cayman Islands-situated assets.

In addition, a Cayman Islands trust can help to ensure that the Cayman Islands-situated assets can be dealt with according to the wishes of the settlor, rather than according to forced heirship rules of other jurisdictions.

IV WEALTH STRUCTURING AND REGULATION

i Cayman Islands trusts

Cayman Islands trusts frequently form an important part of a family’s wealth planning for many reasons. For example, they can be used to preserve capital while providing an income stream for current and future generations, or they can be established to ensure that the family wealth is professionally managed and protected for its intended purpose beyond the lifetime of the current generation. Trusts may also be established to avoid the inconvenience and publicity of probate, or perhaps to create certainty as to the devolution of assets on death where forced heirship laws might otherwise be argued to apply. Depending on the particular circumstances, there can be advantages in setting up trusts in a jurisdiction like the Cayman Islands that has developed a specialised industry.

Trusts established under Cayman Islands law adopt the common law concepts of a trust, whereby a trustee (the legal owner of the assets under a trust) holds the assets beneficially for the beneficiaries of the trust in accordance with the terms of the trust instrument. Indeed, a Cayman Islands trust does not have a separate legal personality.

As mentioned previously, the law of trusts in the Cayman Islands is primarily grounded in the rules of common law and supplemented by local statues, including the Trusts Law (2017 Revision). The Trust Law is the main source of legislation governing the creation and administration of trusts in the Cayman Islands, while CIMA regulates the services provided by trust companies.

The Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (the Hague Trusts Convention) has not been extended to the Cayman Islands. However, there is nothing in local legislation that would prevent most types of internationally accepted trusts as being recognised in the Cayman Islands.

ii Reserved powers

The Cayman Islands was the first jurisdiction to adopt reserved powers legislation that replaces the common law position in regard to the settlor-directed trust. The legislation, now part of the Trust Law, lists certain powers that may be reserved by a settlor, or conferred upon the protector, without invalidating the trust. In particular, the legislation expressly confirms that it is quite proper and shall not cause the trust to be set aside for the trust instrument to reserve the following unto the settlor:

a any power to revoke, vary or amend the trust instrument;
b a general or special power to appoint either income or capital of the trust property;
c any limited interest in the trust property;
d a power to act as director or officer of a company wholly or partly owned by the trust;
e a power to give binding directions to the trustee in connection with the purchase, holding or sale of trust property;
f a power to appoint, add or remove any trustee, protector or beneficiary;
g a power to change the governing law; or
h a power to restrict the exercise of any powers of the trustee by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the trust instrument.

Many other jurisdictions have subsequently introduced similar forms of restricted powers legislation.

iii STAR trusts

The Cayman Islands created a special type of trust, commonly known as a STAR trust, enacted by the Special Trusts (Alternative Regime) Law 1997 (STAR Law) and is now consolidated with, and contained in, the Trust Law. The intent of the STAR Law was to create an alternative regime under which a new trust, whether for purposes or persons or both, could be created.

To create a valid STAR trust, the trust instrument must include a declaration that the STAR Law provisions apply. In addition, at least one of the trustees of a STAR trust must be a trust company licensed in the Cayman Islands.

There are a number of features that distinguish the STAR provisions from the purpose trust legislation of other jurisdictions. These include the following:

a The objects of a STAR trust may be persons or purposes: the persons may be of any number and the purposes may be of any number or kind, charitable or non-charitable, provided they are lawful and not contrary to public policy. This differentiates from the position in other jurisdictions, where it must be decided whether a trust is a purpose trust or a person trust before deciding whether the purpose trust law applies.

b The rule against perpetuities that limits other types of trusts in the Cayman Islands to the statutory perpetuity period of 150 years does not apply to a STAR trust and, therefore, a STAR trust can have perpetual existence.

c The STAR provisions stipulate that a STAR trust is not rendered void by uncertainty as to its objects or mode of execution. It allows the trust deed to give the trustee or any other person power to resolve an uncertainty as to its objects or mode of execution.

d The STAR provisions deal comprehensively with the issue of enforcers. They provide that the only persons who have standing to enforce a STAR trust are such persons, whether or not beneficiaries, as are appointed to be enforcers by the terms of the trust deed, or in certain circumstances by order of the court. Therefore, beneficiaries who are not enforcers have no right to enforce the trust or to obtain information regarding the trust.

iv Foundations

The Foundation Companies Law, 2017 introduced a new vehicle to the Cayman Islands that can be used for a wide variety of applications including private, commercial or philanthropic purposes. The foundation company employs the well-known advantages of a company but has greater flexibility over the objects, management and supervision to enable it to be tailor-made to the founder’s objectives. This vehicle is especially attractive to those clients in civil law jurisdictions who are considering a wealth planning structure as the instrument feels like a company while retaining the adaptability of a trust.
In order for a new company to qualify as a foundation company (or for an existing company to convert to a foundation company) it will be required to register as a foundation company and have the following characteristics:

\( a \) the foundation company can be limited by shares or by guarantee, with or without share capital;

\( b \) in its memorandum of association, it must state that it is a foundation company, include a description of its objects (which may but need not, be beneficial to other persons), provide for the disposal of any surplus assets on winding up and prohibit dividends or other distributions of profits or assets to members;

\( c \) in addition to adopting articles of association, the foundation company may adopt bespoke by-laws that provide greater flexibility; and

\( d \) appoint a qualified person as secretary of the foundation company.

The foundation company is a legal person and thus any uncertainty over the validity of a structure are negated where this vehicle is used for wealth planning. Another significant comfort to potential founders is that the ‘firewall provisions’ ingrained in the Cayman Islands Trust Law will also apply generally to assets contributed to foundation companies.

\( v \) Regulation

Trust companies in the Cayman Islands are regulated by CIMA through the various licences granted and registrations required. Generally, there are two types of licence granted to trustees carrying on a trust business in Cayman:

\( a \) a full trust licence entitles the holder to provide trustee services to the public generally; and

\( b \) a restricted trust licence is issued subject to the condition that the trust business is limited to certain named clients. A restricted licence trust company is restricted to acting as trustee to specific named trusts that are for related parties or a specific group. All directors and senior officers (including any changes after licensing) must be approved by CIMA.

\( vi \) Registered private trust companies

The Cayman Islands has been a leading jurisdiction for the creation of registered private trust companies (PTCs). A PTC is generally established by a wealthy family to act as trustee of specific family trusts. It allows stakeholders to retain a level of influence over their family trusts as they can have input into the choice of the directors of the PTC or potentially to serve as directors themselves. The PTC may also allow greater flexibility when it comes to the choice of investment strategy and advisers, or generally to fulfil the trustee role in a different way to a fully licensed trust company because it has a more focused mandate and risk profile. Often, a PTC is run in conjunction with a family office or with a specific group of trusted advisers that have a legacy connectivity and familiarity with the family.

The Private Trust Company Regulations (the Regulations) introduced in 2008 allow a trust company that is incorporated in the Cayman Islands and that conducts no trust business other than connected trust business to register as a registered PTC. Connected trust business is defined as trust business in respect of trusts, the contributors of which are all, in relation to each other, connected persons.
The effect is that PTCs set up to act as trustees of specific family trusts can be exempt from licensing. Where a PTC chooses not to be licensed and to rely on the exemption allowed by the Regulations, it must register with CIMA by paying an initial registration fee and by filing an annual declaration.

vii Data security and confidentiality

The Confidential Information Disclosure Law 2016 came into force in July 2016 with the repeal of its predecessor, the Confidential Relationships (Preservation) Law (2009 Revision) (CRPL). The new Confidential Information Disclosure Law revises the Cayman Islands’ approach to confidential information to be in line with the UK and most common-law jurisdictions. The criminal penalties that accompanied the old CRPL have been removed, but importantly, it retains the mechanism for seeking court approval for certain disclosures, which ensures that the rights to privacy of information remain well protected. The new Confidential Information Disclosure Law also preserves many of the previous statutory exemptions through which disclosure of confidential information was permitted, including with prior consent or in the normal course of business. Notably, the new Confidential Information Disclosure Law also introduces a whistle-blower defence for disclosures made in good faith in certain scenarios. Overall, the Law is a more user-friendly piece of legislation that continues to protect privacy and the unwarranted publication of confidential information, while allowing compliance at the global level with adequately substantiated information requests.

The Data Protection Law 2017 was passed by the Cayman Islands government in March 2017 and introduces a legislative framework for data protection that will apply to many of the entities established in the Cayman Islands. The legislation, which is based on the Data Protection Act 1998 of the United Kingdom, regulates specific protection of personal privacy rights and instructs Cayman Islands entities on how they must handle personal records. There are eight data protection principles that form the basis of the law:

- personal data shall be processed fairly and only when specific conditions are met, for instance where consent has been given, where there is a legal obligation, or where it is necessary for performance of a contract to which the data subject is a party;
- personal data ought to be obtained only for one or more specified lawful purposes;
- personal data shall be adequate, relevant and not excessive in relation to the purpose or purposes for which they are collected or processed;
- personal data shall be accurate and, where necessary, kept up to date;
- personal data shall not to be kept for longer than is necessary for the purpose;
- personal data shall be processed in accordance with the rights of individuals as specified under the legislation;
- personal data shall be protected by appropriate technical and organisational measures against unauthorised or unlawful processing, and against accidental loss, destruction or damage; and
- personal data shall not be transferred abroad unless the country or territory to which it is transferred ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data.

It is noted that the Data Protection Law 2017 contains a number of exemptions that may apply, including in relation to trusts, which ensure the integrity of the trust structure is maintained against prejudiced claims.
The Cayman Islands recognises that the vulnerability of entities operating in international financial centres, such as the Cayman Islands, has been heightened, as have the consequences of security breaches. Given the heightened risks, CIMA has reviewed and strengthened its own security strategy. Along with central government and the Information and Communication Technology Authority, CIMA has taken the decision to adopt the National Institute of Standards and Technology Cybersecurity Framework, which is a risk-based set of guidelines designed to help organisations assess current capabilities and create a prioritised roadmap towards improved cybersecurity practices. Going forward, CIMA will review the approach of licensed trust companies to data security risk management. Depending on the trust company’s business and risk profile, they will examine one or more of the following areas: technical controls, incident response and staff training. As part of the reviews, CIMA will also consider the trust company’s ability to protect the confidentiality, integrity and availability of sensitive customer and other information.

viii Money laundering regime
As a leading international financial centre, the Cayman Islands has framed its regulatory system around international standards of supervision and cooperation with overseas regulatory authorities. Professionals working in the financial services industry in the Cayman Islands must abide by the Proceeds of Crime Law, as supplemented by the Money Laundering Regulations and Guidance notes.

The Cayman Islands has accepted the Financial Action Task Force’s (FATF) Forty Recommendations on the Prevention of Money Laundering and Nine Special Recommendations on Countering Terrorist Financing, which are the international standards for effective anti-money laundering and counter-terrorist financing regimes.

The Cayman Islands is a member of the Caribbean Financial Action Task Force (CFATF) and observes the CFATF’s 1992 Kingston Declaration on money laundering. This declaration endorsed the implementation of the 1988 United Nations Vienna Convention, the Organisation of American States Model Regulations, the FATF’s Forty Recommendations and the 19 Regional Specific Objectives.

ix Beneficial ownership
The Cayman Islands commenced new laws on 1 July 2017 that introduced enhancements to its existing beneficial ownership regime. The new legislation requires certain companies incorporated under the Cayman Islands Companies Law to maintain a register of beneficial ownership at the registered office of the relevant company. This information will be uploaded to a non-public, secure centralised platform maintained by the government. In general, the register must contain the names and details of all individuals and certain relevant legal corporate entities holding (directly or indirectly) more than 25 per cent of the shares or voting rights in the company or the right to appoint or remove a majority of the company’s board of directors.

There are exceptions to the regime and companies falling out of its scope are not required to prepare and maintain a beneficial ownership register; however, they are required to file details of the exemption applicable to them. A company is deemed out of the scope of the beneficial ownership regime if it falls within one of the categories below or is a subsidiary of a legal entity that falls within one of these categories:

a) listed on the Cayman Islands Stock Exchange or an approved stock exchange;
b) registered or holding a licence under a regulatory law in the Cayman Islands;
 managed, arranged, administered, operated or promoted by an approved person as a special purpose vehicle, private equity fund, collective investment scheme or investment fund;

regulated in a jurisdiction deemed to have an equivalent anti-money laundering framework to the Cayman Islands;

a general partner of a vehicle, fund or scheme that is registered or holds a licence under a regulatory law; or is managed, arranged, administered, operated or promoted by an approved person; or

holding directly a legal or beneficial interest in the shares of a legal entity that holds a licence under the Banks and Trust Companies Law (2018 Revision), the Companies Management Law (2018 Revision), the Insurance Law (2010 Revision), Part III of the Mutual Funds Law (2015 Revision) or the Securities Investment Business Law (2015 Revision).

The Cayman Islands signed a Model 1B (i.e., non-reciprocal) intergovernmental agreement with the United States to implement the US Foreign Account Tax Compliance Act (FATCA). The jurisdiction has also signed an intergovernmental agreement with the United Kingdom to implement UK FATCA, which will be phased out and replaced by the CRS.

The jurisdiction is an ‘early adopter’ of the CRS, having agreed to the exchange of financial account information with the first group of participating jurisdictions by September 2017.

The Department for International Tax Cooperation (DITC) in the Cayman Islands has issued guidance notes for FATCA and CRS and all reporting under the regimes will be directly submitted to the DITC in the Cayman Islands.

The Cayman Islands introduced country-by-country reporting (CbCR) legislation in 2017 as part of its commitment to comply with Action 13 of the OECD/G20 Action Plan on Base Erosion and Profit Shifting (BEPS). CbCR requires multinational enterprises that meet certain criteria to file a report with tax authorities. The reports provide a breakdown of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which the multinational enterprise group does business. This legislation only applies to multinational enterprise groups with an annual consolidated group revenue of at least US$850 million in the preceding fiscal year.

The Tax Information Authority (International Tax Compliance (Country-by-Country Reporting) Regulations 2017 require reporting entities resident in the Cayman Islands to collect, maintain and report information for exchange with partner jurisdictions and impose a notification obligation on certain relevant entities resident in the Cayman Islands.

The Cayman Islands is cognisant of the fact the jurisdiction's thriving trust industry exists as part of a global economy. Therefore, every effort is made to increase international cooperation and collaboration, without compromising proper rights to confidentiality of its users to ensure compliance with financial services best practice.
As with other sectors, trust legislation in the Cayman Islands continuously evolves to meet the ever-changing needs of the financial and private client industry, as well as to adapt to the need for effective compliance at the highest global standard. At present, there is proposed legislation for further amendments to the Trust Law legislation. We also expect revised regulations on private trust companies, which will further increase the attractiveness of the Cayman Islands for the establishment of private trust companies.

Recently, there has been continued dialogue regarding the transparency of beneficial ownership in all jurisdictions. The government has been proactive in this regard, and continues to liaise with appropriate officials, to ensure its solution maintains the confidentiality and security of client data for private entities by ensuring the platform is offline and not open to the public at large, while ensuring proper authorities conducting legitimate investigations can obtain relevant information on a timely basis.

While historically the creation of trusts offshore was often driven by efficient tax planning, for the current generation this has changed. Tax considerations continue to be a factor; however, the focus is now on planning for the wealth succession for future generations of the family and protection of assets from improper external threats. The Cayman Islands provides a tax-neutral, stable, sophisticated environment for such planning.

Looking forward, local substance of services and potentially family office presence in the relevant jurisdiction may become ever more important. There is proposed family office legislation in the pipeline that will ensure family offices can establish a substantive presence in the Cayman Islands efficiently. The Cayman Islands boast world-class living accommodation, restaurants, schools, political stability and a legal framework that is attractive to families considering establishing a presence in the jurisdiction. The expert service providers in the Cayman Islands can assist stakeholders with an efficient and effective strategy to establish or move structures to the jurisdiction.
INTRODUCTION

Chile is a democracy with a president elected by popular vote. Legislative power is exercised by a bicameral congress, which is also elected by popular vote. The election process of authorities has been democratic throughout the last 30 years, with successive transitions between left and centre-right governments, without hindrances.

Chile's political economy is considered very stable. Its primary industries are related to the export of natural resources such as minerals and metals (mostly copper), produce, lumber and forestry by-products, and fish.

From a tax perspective, Chile was one of the first members of the Organisation for Economic Co-operation and Development (OECD) in South America. Currently, it has double taxation treaties in force with the following countries: Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Colombia, Croatia, the Czech Republic, Denmark, Ecuador, France, Ireland, Italy, Japan, Korea, Malaysia, Mexico, Norway, New Zealand, Paraguay, Peru, Poland, Portugal, Russia, South Africa, Spain, Sweden, Switzerland, Thailand and the United Kingdom. Double taxation treaties with the United States and Uruguay have been signed but are not yet in force. In addition, Chile has recently signed the OECD's Convention on Mutual Administrative Assistance in Tax Matters.

In recent years, a number of tax reforms have been introduced, which are in line with OECD regulations. In 2012, indirect transfer and transfer pricing regulations were incorporated in the Income Tax Law (ITL). In 2014, Law No. 20,780 and subsequent Law No. 20,899 (which simplifies aspects of Law No. 20,780) were enacted. These two pieces of law are together referred to as the Tax Reform, and they introduced significant changes to Chilean tax legislation. The Tax Reform's changes entered into force progressively until complete effectiveness on 1 January 2017.

In the context of the Tax Reform, the Chilean Internal Revenue Service (SII) has issued numerous regulations and opinions in the form of Official Letters, Instructions and Rulings, clarifying the practical application of the Tax Reform.

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1 Pablo Chechilnitzky R is a partner at Recabarren & Asociados.
II TAX

i Individuals taxation

In general terms, individuals domiciled or resident in Chile and legal entities incorporated in Chile are subject to tax worldwide. On the contrary, non-resident and non-domiciled individuals or legal entities are only taxed for their Chilean source income.

Taxpayers domiciled or resident in Chile are subject to second category tax or global aggregate tax depending on the nature of the income obtained. Employment income obtained from the exercise of liberal professions (independent or dependent workers) is subject to second category tax, ranging from 0 to 35 per cent (progressive tax) monthly.

On the other hand, any income other than employment (i.e., interests, dividends and rental, among others) that an individual receives is subject to global aggregate tax at the same rate as second category tax, but annually.

ii Foreign taxpayers

Taxpayers that are not domiciled or resident in Chile are subject to additional tax or withholding tax on their Chilean source income at a general rate of 35 per cent.

The above rate may be reduced (or even exempt) depending on the type of income or circumstances surrounding the transaction, such as the application of a double taxation treaty.

iii Corporate taxation

In general, the net taxable income of a corporation is calculated annually by deducting from the year’s gross revenues all expenses that are necessary to produce such income and that have not been imputed as a cost.

The 2014 Tax Reform introduced to the ITL two main separate regimes for companies to determine their corporate income tax (first category tax (FCT)): the Attributed Regime and the Partially Integrated Regime.

The following are the main aspects of each regime.

Attributed Regime

Under this regime, income received or accrued by a company is attributed annually to its shareholders or partners, regardless of whether any dividend or profit distributions were made.

In general terms, taxable income generated by a legal entity will be subject to 25 per cent FCT. The grossed up taxable income will then be attributed to the entity's final shareholders or partners, be they Chilean individuals or foreign legal entities or individuals, and regardless of whether any cash has been distributed to them.

Upon attribution, final shareholders or partners will be subject to additional tax or global aggregate tax, and will have the right to use FCT paid at the legal entity level as a credit. As a result, local individuals will be subject to a maximum overall taxation of 35 per cent, and foreign taxpayers will be subject to an effective 35 per cent tax rate.

Partially Integrated Regime

Under the Partially Integrated Regime, shareholders or partners are only taxed on the effective distribution of dividends or profits by the legal entity.

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2 Other special tax regimes are available for medium and small enterprises and other special taxpayers.
The FCT rate for the Partially Integrated Regime is 27 per cent. Additionally, shareholders or partners are only able to use 65 per cent of FCT paid by the legal entity as a credit against additional tax or global aggregate tax. Under this regime, final taxpayers are required to reimburse 35 per cent of FCT credit available. This results in FCT credit being limited to 65 per cent of FCT paid at the legal entity’s level.

As a result of this FCT credit limitation, taxpayers under this regime, whether local or foreign shareholders or partners, are subject to a maximum overall taxation of 44.45 per cent over distributed income.

An exception to the 35 per cent FCT credit reimbursement applies to foreign shareholders or partners who are domiciled in a country that has a double taxation treaty with Chile, making the total tax under a treaty scenario return to a 35 per cent rate over the effective distribution of dividends or profits.

While double taxation treaties signed by Chile provide different rates for dividend and profit distributions, these dispositions do not apply to distributions made from Chile. In fact, Chile has made a reserve regarding the application of dividend distribution reduced rates (the Chilean Clause) as long as FCT is creditable against additional tax. Thus, all dividend distributions made to a foreign taxpayer domiciled in a treaty country would still be subject to additional tax at a rate of 35 per cent.

Dividend or profit distributions within Chilean legal entities are not subject to tax.

Regarding the applicability of the tax regimes, the ITL states that entities comprised exclusively by individuals, foreign shareholders or partners may elect the Attributed Regime. However, this regime in not available for Chilean corporations or partnerships limited by shares. Accordingly, the Partially Integrated Regime is mandatory for all types of corporations, limited partnerships by shares, and legal entities that have at least one Chilean legal entity as a shareholder or partner.

Companies can choose the tax regime applicable when they file for their initiation of activities with the SII. Taxpayers that do not exercise their option within the terms stated in the law will be subject to their default regime as determined by the ITL for their legal type.

At the time of writing, the government is analysing a tax reform that simplifies the taxation regimes explained above. It is expected that the Partially Integrated Regime is established as the general tax regime, and that the Attributed Regime remains applicable to medium and small companies. Further, a full integration between the corporate tax paid and final taxes is also expected.

iv Real estate taxation for individuals

In general terms, capital gain generated by individuals domiciled or resident in Chile for the sale of one or more real estate assets, is subject to global aggregate tax.

Notwithstanding the above, a single and substitutive tax of 10 per cent, and a non-taxable gain of 8,000 unidades de fomento\(^3\) may apply if the sale is to an unrelated party and is carried out after one or four years have elapsed from the acquisition (depending on the type of real estate sold). This capital gain is determined by the difference between the tax basis for the asset, calculated as the acquisition price adjusted by local inflation (by the Chilean Consumer Price Index), and its sale price.

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\(^3\) A reference monetary unit used in Chile.
In relation to the sale price, the Chilean Tax Code requires that the sale price be at fair market value (FMV). If this is not the case, the SII will have the power to assess the transaction and collect the taxes that would have applied if the transaction had been executed at FMV (as determined by the SII). However, if the real estate was acquired by the individual before 31 December 2003, the sale will not be subject to tax.

From a value added tax (VAT) perspective, the Tax Reform included the alienation of real estate property in the concept of ‘sale’, provided it is carried out by taxpayers that have the nature of sellers (and therefore deemed as habitual).

The sale of real estate property and other special transactions assimilated to sales, as long as they are made by sellers, is liable to VAT at the rate of 19 per cent. In the application of VAT to these transactions, the value of the land is excluded from the VAT-taxable base. In this sense, the sale of land is not subject to VAT.

Direct capital gain taxation for individuals
The ITL states that income related to goods located or activities developed in the country are deemed as Chilean source income. In this sense, shares of a company incorporated in Chile are deemed as Chilean source income. Therefore, the gain generated in the sale of shares of an entity incorporated in Chile is considered as Chilean source income and is subject to tax regardless of whether the taxpayer is foreign or not.

The capital gain is equal to the positive difference between the tax basis calculated as the acquisition value of the shares duly adjusted by inflation (by the Consumer Price Index), and its sale price.

In relation to the sale price, and as already mentioned regarding real estate, the Chilean Tax Code requires that the sale is executed at FMV.

The capital gain obtained as a result of the disposition of shares will be subject to the general tax regime stated in the ITL, that is, FCT at the rate of 25 or 27 per cent (depending on the regime) if the transferor is a Chilean-incorporated company, or global aggregate tax if the taxpayer is an individual domiciled or resident in Chile. In the latter case, if the sale is to an unrelated party, the individual may choose to consider that the capital gain has been accrued during the period of years that the shares have been in his or her possession, up to a maximum of 10 years. For these purposes, global aggregate tax shall be recalculated for each corresponding year.

The capital gain obtained by a foreign taxpayer should be subject to withholding tax (WHT) at the rate of 35 per cent. Under a double taxation treaty scenario, the rate may be reduced.

Finally, the sale of shares of corporations with a stock market presence that fulfils the requirements of Article 107 of the ITL is not subject to tax.

Indirect transfer
Another relevant rule to be taken into account is the regulation of indirect transfer of Chilean underlying assets through the sale of foreign entities, enacted in 2012.

In general terms, indirect transfer rules apply if 10 per cent or more of a foreign entity is sold, at least 20 per cent of the total market value of the shares, quotas and titles of foreign rights is represented by the Chilean underlying assets, and the Chilean underlying assets
have an FMV greater than 210,000 annual tax units (UTA). Indirect transfer rules would apply, regardless of the percentage sold, if the foreign entity being transferred is located in a tax-haven jurisdiction and certain requirements set by the law are met.

vii Transfer pricing

In 2012, Article 41E on transfer pricing was introduced to the ITL. This regulation defines terms as ‘related parties’, ‘applicable methods’, and the declaration obligations and transfer pricing adjustments.

Taxpayers who carry out transactions governed by this regulation must have and keep a transfer pricing study that supports the methods applied to their transactions, available for the relevant tax authority.

Chilean regulations include methods in line with the OECD regulations, such as comparable uncontrolled price, resale price, cost-plus margin, profit-split and transactional net margin. The regulation also considers the use of any other method if it is the most appropriate, considering the advantages and disadvantages of each one.

Regarding tax compliance, a transfer pricing’s affidavit must be annually submitted on the last business day of the month of June. It must be submitted by medium or large companies that have carried out transactions with foreign related parties for amounts exceeding 500 million Chilean pesos; and by taxpayers who have carried out transactions with persons domiciled or residing in a country or territory considered a jurisdiction with a preferential tax regime. If the Chilean company qualifies as a large taxpayer, transfer pricing regulations will apply regardless of the amount of the transaction.

According to this regulation, if the affidavit is not submitted or is submitted with errors, incomplete or late, a fine of 10 to 50 UTA shall be applied.

viii Withholding tax

Under Chile’s general tax regime, interests and services paid abroad are subject to a tax rate of 35 per cent. For royalties, the WHT rate is 30 per cent. In some cases, such rates may be reduced under local regulation or a double taxation treaty.

In the case of interests, any amount paid or made available to a foreign creditor as interest derived from credits granted by foreign or international banks or foreign financial institutions shall be subject to a final 4 per cent WHT.

ix Foreign tax credit

In terms of foreign tax credit (FTC), the ITL makes a distinction between treaty and non-treaty countries. Under a non-treaty scenario, foreign taxes are only creditable in Chile in relation to dividend income, income derived by permanent establishments, royalties and remunerations for technical assistance or similar services.

Taxes charged overseas on any other income, such as interest, cannot be used as tax credit in Chile. Under a non-treaty scenario, the tax credit available for taxes charged overseas are capped at a 32 per cent. On the other hand, taxes that are levied on income covered by a double taxation treaty (such as interests) are creditable in Chile with a cap of 35 per cent.

Note that the excess of FTC may be carried forward.

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4 A reference monetary unit used in Chile.
x Foreign exchange regulations
Chile does not limit the entry or repatriation of funds. Nevertheless, all transactions exceeding US$10,000 must be informed to the Chilean Central Bank.

xi Regulation on controlled foreign corporations
The tax reform of 2014 incorporated into Chilean legislation regulations on controlled foreign corporations (CFCs). This regulation represents an exception to the general rule of recognition of income from a foreign source on a cash basis.

In general terms, this regulation establishes that, if certain control hypotheses are met, the Chilean taxpayer must recognise income generated by a foreign controlled entity on an accrual basis. This regulation is only applicable to the passive income obtained by the foreign controlled entity, and therefore it does not include income generated by foreign controlled entities that carry out an active business.

Recently, the SII, through Ruling No. 728, published on 15 February 2018, confirmed that – for CFC purposes – there is no relationship between an individual and their spouse or their relatives, but there is between any of them and the respective company. This interpretation may be useful when evaluating a structure. However, there are multiple factors, exceptions and legal assumptions that must be considered when attempting to create a structure with a Chilean holding company that holds investments abroad.

xii General anti-avoidance rules
The Tax Reform incorporated Articles 4 bis, 4 ter and 4 quater of the Tax Code, establishing the general anti-avoidance rules (GAAR).

The purpose of these regulations is to prevent Chilean taxpayers from evading tax regulations through abuse or simulation. These rules are of an exceptional nature, and will not apply if there is a special anti-avoidance rule to prevent avoidance (such as transfer pricing regulations or rejected expenses penalty tax, among others).

In addition, these rules recognise the principle of good faith in tax matters, the effects that arise from the acts or contracts celebrated and the legitimate option of the taxpayer to choose among the various mechanisms provided by the law.

GAAR regulations define abuse and simulation. Abuse is understood to exist when there is a taxable event that may be totally or partially avoided or diminished, or, when the generation of the tax obligation is postponed or deferred. Those transactions, analysed as a whole, shall be considered abusive if they solely intend to cause tax effects and do not produce relevant economic or legal effects. On the other hand, simulation would be deemed to exist in those acts that conceal the configuration of a taxable event, simulate the nature of its elements, the true amount of the tax obligation or the date of the same.

If the tax authority considers that abuse or simulation exists, the taxpayer must first be challenged by the Director of the SII, to subsequently follow a judicial procedure before the Tax and Customs Courts.

In addition, GAAR regulations state that individuals or legal entities who have contributed in the planning of the acts, contracts or businesses that are considered abusive or elusive by the authority shall be subject to a fine of up to 100 per cent of all taxes that should have been paid according to the tax authority’s criteria if the abusive or elusive conduct had not been carried out (this fine is capped at 100 UTA).

Although GAAR regulations were enacted in 2015, there has not yet been any practical application by the SII.
III ESTATE TAXES

Inheritance is regulated in Chile, both from a civil and tax perspective.

From a tax standpoint, the regulations have not undergone any relevant modification (the last modification was in 1998). In this sense, the regulations have not been affected by the Tax Reform and no changes are expected in the near future.

The regulations on inheritance tax will apply to those who have their last address and residence in Chile. The inheritance tax levies each of the hereditary assignments and not the estate of the deceased person (i.e., applied at the level of the inheritor).

To determine the tax due, possessions located abroad must be collated; however, in the case of foreigners, goods located abroad must only be included in the inventory when they have been acquired with resources coming from Chile.

A progressive tax rate ranging from 0 per cent to 25 per cent shall be applied to each heir assignment, with exemptions and surcharges depending on the degree of relationship that exists with the deceased person.

i Intestate succession

If the deceased person has not left a will or did not dispose of its property in a valid and effective way, the law establishes – by means of succession orders – what order and with what priority the heirs are to be called or vested. Not all of them are called with equal priority, as there is a successive order of five levels:

a First order of succession: descendants and spouse. These concur personally or represented. In general, the spouse will be assigned twice as much as each descendent; if there is only one descendent, they will both be assigned the same amount. The spouse must be assigned at least a quarter of the inherited estate if there are more than six descendants.

b Second order of succession: ascendants and spouse. This level only applies if there are no descendants of the deceased person, and includes only the ascendants of the closest degree. The inheritance is divided into three, corresponding two-thirds to the surviving spouse and the remaining third to the ascendants.

c Third order of succession: siblings. These concur personally or represented. Half-siblings will inherit half of what corresponds to full-siblings.

d Fourth order of succession: collaterals. These can only concur personally and up to the sixth degree; the closest degree excludes others.

e Fifth and last order of succession: the Treasury. This only applies if no other heirs of the deceased exist.

ii Succession by will

Wills are unusual in Chile but are common among high net worth individuals. The Chilean succession system does not allow absolute freedom to dispose by will, imposing certain legal restrictions on the testamentary assignments of the deceased. Thus, from the point of view of the deceased, the assignees can be voluntary or forced, the latter corresponding to those imposed by law even against the express will of the deceased person.

Therefore, there is not an absolute freedom to dispose by will, but restrictions exist in those cases in which the deceased has forced assignees, making it able to dispose freely of only a quarter of his or her estate.
iii  Marriage regimes:

Marriage is defined by law as a contract between a man and a woman, hence marriage between same-sex couples is not allowed. Marriage gives rise to a series of obligations, one of which is that the spouses are forced heirs of each other.

Joint property or communal property regime

This is the default legal regime. The assets acquired during marriage form part of the communal property. The ordinary administration corresponds to the husband; however, certain acts require the wife’s authorisation. It exists between husband and wife and not with respect to third parties, for whom the husband is identified with the joint or communal property and is considered the owner of the social assets.

Women married under this regime are allowed to keep property under their administration separate from those of the community. These separate assets are basically comprised of assets or goods acquired with income from the wife’s work.

In accordance with the provisions of the ITL, the gain obtained in the allotment of goods in favour of any of the spouses owing to the dissolution of this regime is not considered income for tax purposes, hence, the assets could be assigned at their FMV without generating a taxable event. The tax basis of these assets will be that which is considered in the allotment.

Total separation of property regime

Under this regime, each spouse manages his or her assets with complete freedom and independence; both must provide for the needs of the common family in the proportion of their economic weight.

Finally, there is the regime of participation in earnings, which is uncommon.

Civil union agreement: Law No. 20,830 enacted in 2015

This is the legal framework that makes possible the legal union between two people of the same sex. It is a solemn contract between two people who share a home, with the purpose of regulating the legal effects derived from their life in common.

The default regime is that of total separation of property; however, a community can be elected at the time of the agreement, this being the only opportunity for the election.

Each civil partner is a forced heir of each other, and will concur in his or her succession in the same way and enjoy the same rights of the surviving spouse. Therefore, the civil partner will concur jointly with the descendants or ascendants of the deceased civil partner.

IV  WEALTH STRUCTURING AND REGULATION.

Currently, the use of foreign foundations or trusts by Chilean taxpayers has diminished, in part owing to the enactment of CFC regulations.

On the other hand, Chilean taxpayers with existing foreign structures that were not in compliance with local regulations took advantage of the temporary tax amnesty included in the Tax Reform of 2014.

This special tax amnesty allowed the disclosure and recognition of previously undeclared foreign source income at a flat 8 per cent tax rate. The funds that were subject
to this alternative tax are considered to have fully complied with their final taxation; hence, taxpayers can freely repatriate or invest these funds abroad without further taxation. However, the return obtained over these funds will be subject to taxation under the general rules.

In recent years, partnerships with their equity divided by shares (SpAs) have been one of the most common corporate structures in Chile. This legal form has attributes from both partnerships and corporations, it has limited liability for its shareholders and it allows flexibility in its administration without the need to establish a board of directors or hold shareholders’ meetings regularly.

In this sense, the legislator gave freedom to the shareholders to include particular regulations in the by-laws with few limitations. One of its particularities is that its shares can be owned by a sole shareholder without triggering its absorption or dissolution (as would be the case for a corporation or partnership that requires at least two shareholders or partners).

High net worth individuals and families have made the signing of family protocols and shareholder agreements frequent. These instruments seek to regulate the operation, administration and eventual sale of family businesses, seeking to achieve harmonious transitions through family generations and allow the efficient use of resources.

These protocols and agreements are made separately from, or are often incorporated directly into, the by-laws of SpAs, generating a single document that regulates relationships between family members efficiently.

Common clauses include, among others, the creation of different classes of shares with preferential economic or political rights, veto powers, and first offer, drag-along or tag-along clauses.

V OUTLOOK AND CONCLUSIONS

Chile is a stable country with a broad treaty network and a strong financial system, making it a good alternative for foreign investors that look for a Latin American holding company or investment platform.

From a tax standpoint, Chile has in recent years undergone a series of tax reforms that have introduced CFC, transfer pricing and GAAR regulations, among others. However, the new regime introduced by the Tax Reform has proven to be difficult to apply and is expected to be subject to further modifications, including the full integration of corporate and final taxes.
Chapter 15

CYPRUS

Elias Neocleous and Elina Kollatou

I INTRODUCTION

Despite being among the smallest countries in terms of area and population, Cyprus has developed into one of the world’s most important financial and business centres. It has numerous advantages, including a strategic location, membership of the EU and the eurozone, a mature and transparent legal system, world-class professional and financial services and a modern, business-friendly tax regime, which offers attractive planning opportunities.

During the years following perestroika, Cyprus developed into the portal of choice for investment from the West into the rapidly developing economies of Russia and central and eastern Europe.

Even the largest Russian and eastern European companies have a substantial degree of owner involvement, and high net worth individuals from the region have found Cyprus an excellent location for their personal financial affairs. In 1992, Cyprus enacted the International Trusts Law, which gave investors from overseas formidable asset protection and tax mitigation opportunities, and allowed individuals from jurisdictions with forced heirship regimes to effectively regain testamentary freedom.

The links between eastern Europe and Cyprus extend beyond finance. Both share a common Orthodox religious culture and Cyprus is home to tens of thousands of Russians and eastern Europeans.

Today, Cyprus is a low-tax jurisdiction with a modern tax regime and an extensive network of double taxation treaties, allowing effective tax planning. All forms of succession taxes were abolished in 2000. It has world-class professional and financial services and a robust legal infrastructure founded on common law. It enjoys an excellent climate and a high standard of living, and its strategic location at the crossroads of Europe, Asia and Africa gives it a cosmopolitan atmosphere. While Russia and central and eastern Europe remain the key markets for Cyprus, China, India and the Middle East are also significant. The island is home to a large number of extremely wealthy individuals and the financial base for many thousands of non-residents.

II TAX

i Introduction

Cyprus offers a benign personal tax system, with generous allowances and a top rate of 35 per cent on taxable income in excess of €60,000. Passive interest and dividends are exempt

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1 Elias Neocleous is managing partner and Elina Kollatou is an associate at Elias Neocleous & Co LLC.

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from income tax. A special defence contribution (SDC) tax is payable on interest, dividends and rents received by individuals if they are both resident and domiciled in Cyprus (see below); individuals who are resident but not domiciled in Cyprus are not liable to SDC. There are no succession taxes and all capital gains, apart from those deriving from the disposal of real estate located in Cyprus, are exempt from taxation.

**ii  Personal income tax**

The tax year is the calendar year and individuals are considered resident if they are present in Cyprus for more than 183 days in the relevant year. In addition, with effect from 1 January 2017, individuals who meet all the following conditions in respect of a given tax year will also be deemed to be tax-resident in Cyprus if:

\(\text{a} \) they are physically present in Cyprus for one or more periods amounting to at least 60 days;

\(\text{b} \) they do not remain in another country for one or more periods exceeding 183 days;

\(\text{c} \) they are not tax-resident in another country;

\(\text{d} \) they undertake business in Cyprus, have employment in Cyprus or hold a post in a Cyprus-resident company that continues to the end of the tax year; and

\(\text{e} \) they maintain a permanent residence at their disposal for their use in Cyprus.

Individuals who satisfy the criteria may obtain a tax residence certificate by completing the prescribed form (T.126 (2017)) and submitting it to the Tax Department together with evidence of arrival and departure in Cyprus, property title deeds or lease contract, and evidence of employment.

Cyprus residents are taxed on the basis of worldwide income, irrespective of whether it is remitted to Cyprus. Husbands and wives are taxed separately. Persons who are not resident in Cyprus are subject to income tax on income accruing or arising from sources in Cyprus.

Personal income tax rates are as follows:

<table>
<thead>
<tr>
<th>Income band</th>
<th>Tax rate</th>
<th>Cumulative tax at top of band</th>
</tr>
</thead>
<tbody>
<tr>
<td>€0–€19,500</td>
<td>0%</td>
<td>0</td>
</tr>
<tr>
<td>€19,500–€28,000</td>
<td>20%</td>
<td>€1,700</td>
</tr>
<tr>
<td>€28,000–€36,500</td>
<td>25%</td>
<td>€3,775</td>
</tr>
<tr>
<td>€36,500–€60,000</td>
<td>30%</td>
<td>€10,885</td>
</tr>
<tr>
<td>€60,000 and above</td>
<td>35%</td>
<td>~</td>
</tr>
</tbody>
</table>

Relief is given for donations to approved charities, professional and trade union subscriptions, life insurance premiums and contributions to pension, social insurance and welfare funds. Relief may also be available under a double taxation treaty.

Resident expatriate employees or secondees are subject to income tax on their worldwide income at the rates shown in the table above.

For tax years up to and including 2014, individuals becoming tax-resident and taking up employment in Cyprus were entitled to an exemption of 20 per cent of their annual income from employment in Cyprus for the first three years of residence. The exemption was limited to €8,550 per annum. With effect from the 2015 tax year, the exemption was extended to five years, but it will be available only until the year 2020.

In 2012, an alternative exemption was introduced for highly paid individuals, exempting 50 per cent of the first five years’ income from employment in Cyprus of a person who was
not previously resident in Cyprus, provided the income from employment in Cyprus exceeds €100,000 per annum. With effect from the 2015 tax year, the exemption period of five years was extended to 10 years. In respect of employments beginning on or after 1 January 2015, the exemption is not available to anyone who was resident in Cyprus in any three of the five tax years preceding the year in which the employment in Cyprus began, or to anyone who was resident in Cyprus in the year preceding the year in which the employment began.

The exemption is available in respect of any tax year in which income from employment exceeds €100,000, irrespective of whether the income falls below that amount in any intermediate year, provided that when the employment started the income exceeded €100,000 and the tax authorities are satisfied that the variations in the annual income are not made for the purpose of obtaining this tax benefit.

The two exemptions are mutually exclusive and each taxpayer may only claim one.

**Exemptions and special cases**

The following are exempt from income tax:

- **a** passive interest and dividends receivable by individuals (these are subject to SDC tax unless the individual is not domiciled in Cyprus – see below);
- **b** lump sums received on retirement;
- **c** profit from the sale of shares;
- **d** capital sums from approved life assurance policies and provident or pension funds;
- **e** income from employment services provided abroad to a non-resident employer or an overseas permanent establishment of a resident employer for a period exceeding 90 days in the tax year;
- **f** certain pensions, such as a widow’s pension;
- **g** salaries of officers and crew of ships owned by a Cyprus shipping company that sail under the Cyprus flag and operate in international waters; and
- **h** income from a qualifying scholarship, exhibition, bursary or similar educational endowment.

For income tax purposes, a 20 per cent deduction is allowed from rental income received. The first €3,420 per annum of any foreign pension is free of tax and the excess over that amount is taxed at 5 per cent.

**Special defence contribution tax**

SDC tax is payable by individuals who are both resident and domiciled in Cyprus on interest, dividend and rentals received at the rates set out below. Individuals who are resident but not domiciled in Cyprus enjoy a full exemption from SDC on all investment income generated on a worldwide basis. Residence is determined in the same way as for income tax purposes.

The principles set out in the Wills and Succession Law, which follow the principles of English common law, are used to determine domicile. In summary, an individual acquires a domicile of origin at birth. It is generally the same as the domicile of the father at the time of birth, and in exceptional cases that of the mother. A domicile of origin may be replaced by a domicile of choice if in actual fact an individual permanently establishes himself or herself in another country with the intention of living there permanently and dying there. However, an individual will be deemed to be domiciled in Cyprus if he or she has been a tax resident for 17 or more of the 20 tax years immediately preceding the year of assessment.
Taken together with the income tax exemption, this means that an individual who is not domiciled in Cyprus is exempt from all Cyprus taxation on interest and dividends from all sources.

Relief or credit for tax paid abroad may be available either under the terms of a double tax treaty or by way of unilateral relief.

<table>
<thead>
<tr>
<th>Type of income</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>17%*</td>
</tr>
<tr>
<td>Interest</td>
<td>30%</td>
</tr>
<tr>
<td>Rents</td>
<td>3% of 75% of the rent</td>
</tr>
</tbody>
</table>

*3% on dividends paid by collective investment schemes

### iii Capital gains tax

There is no taxation of capital gains in Cyprus apart from gains made on the disposal of real estate located in Cyprus or on the shares of companies directly or indirectly holding real estate in Cyprus (in which case the taxable gain is the gain attributable to the real estate holding). To stimulate the real estate market, an exemption was introduced for immovable property acquired between 16 July 2015 and the end of 2016, provided that the property was acquired on an arm's-length basis and not under the foreclosure provisions of the Transfer and Mortgage of Immovable Properties Law. Any gain on the disposal of the property will be exempt from capital gains tax, irrespective of the date of disposal.

As an added incentive, the normal transfer fees payable to the Department of Lands and Surveys on acquisition of immovable property were discounted to 50 per cent of the standard rate until the end of 2016, provided that the property was acquired on an arm's-length basis and not under the foreclosure provisions of the Transfer and Mortgage of Immovable Properties Law. Alternatively, if value added tax (VAT) is payable on the purchase of the property, no transfer fee is payable at all, provided that the sale agreement is deposited with the Land Registry by 31 December 2016. In July 2016, the reduction in transfer fees was made permanent by the Lands and Surveys Department (Fees and Rights) (Amendment) (No. 2) Law.

### iv Succession taxes

There are no succession taxes in Cyprus.

### III SUCESSION

Cyprus’s succession law reflects the cosmopolitan nature of the island and gives an interesting insight into its history. The current succession law dates back to when Cyprus was a British colony and the wording of the law and many of its provisions are unmistakably English, but Cyprus succession law also enshrines the concept of forced heirship, usually associated with civil law and Islamic countries, and recognises the rights of widows of polygamous marriages.

It was modified in 2015 by the entry into force of the European Succession Regulation, which applies a single national law of succession to a person’s movable and immovable property on death, both for testate and intestate succession. The applicable law is that of the country of the deceased’s habitual residence at the time of death, unless the deceased was...
manifestly more closely associated with another country, or the deceased elected in his or her will for their national law to apply, regardless of whether the European Succession Regulation applies in the state of their nationality or not.

Cyprus succession law is set out in a number of enactments, the most significant of which are the Wills and Succession Law (WSL) and the Administration of Estates Law. The WSL deals with both wills and intestacy. The part dealing with wills is based on the English Wills Act of 1837, whereas the part dealing with intestacy is based on the Italian Civil Code and reflects continental law. Cyprus succession law, therefore, can be said to represent a mixture of common and civil law, in roughly equal proportions.

If an individual dies leaving certain categories of relatives, part of his or her estate, known as the statutory portion, is reserved for them and distributed according to the rules of intestacy. The actual proportion of the net estate taken up by the statutory portion varies according to which relatives survive the deceased person and can be as much as three-quarters of the net estate.

Individuals who would otherwise be subject to the forced heirship provisions can easily regain the freedom to dispose of their property as they wish by using a domestic trust or a Cyprus international trust.

IV WEALTH STRUCTURING AND REGULATION

i Introduction

As with succession law, Cyprus offers wealth-holding structures typical of both common law jurisdictions (in the form of trusts) and civil law jurisdictions (in the form of foundations). Foundations are rarely used in practice because of the high degree of bureaucracy under the Associations and Foundations Law of 1972 and trusts overwhelmingly predominate. However, a new law on foundations has recently been enacted, which simplifies procedures and which should lead to an increase in the use of foundations.

Cyprus’s first law on trusts, the Trustee Law of 1955, dates back to when the island was a British colony and is a near replica of the English Trustee Act 1925. The English doctrines of equity were formally introduced into the post-independence legal order by Section 29 of the Courts of Justice Law, Law 14 of 1960, which requires the courts to follow English common law and equitable principles unless there are other provisions to the contrary under Cyprus law or such adherence would be inconsistent with the Constitution of Cyprus.

ii Cyprus international trusts

In 1992, Cyprus created a state-of-the-art international trusts regime with the enactment of the International Trusts Law, Law 69 of 1992 (the 1992 Law), which provides a framework for the establishment of trusts in Cyprus by non-residents.

The 1992 Law introduced a new type of trust, known as an international trust, with tax planning advantages and robust asset protection features. Like similar laws in other jurisdictions, the 1992 Law was not a comprehensive codification and the Trustee Law 1955 applies to international trusts except where the 1992 Law provides otherwise.

Cyprus international trusts proved extremely popular with high net worth individuals and professionals, and a number of other jurisdictions introduced similar regimes. Towards the end of the first decade of the current century it became apparent that the international trusts regime in Cyprus had fallen behind those of its competitors. The International Trusts (Amendment) Law of 2012, which entered into force in March 2012, addressed the
perceived deficiencies and brought Cyprus back to the forefront of leading trust jurisdictions. It clarified the eligibility provisions for Cyprus international trusts, strengthened their already formidable asset protection features, gave settlors far more flexibility than under the 1992 Law and widened trustees’ investment powers. It also made several technical amendments and aligned the International Trusts Law with the EU acquis communautaire. The Amending Law of 2012 does not repeal and replace the 1992 Law but instead builds on it. Section 15 provides that it applies to trusts created before it came into effect.

The Cyprus international trust is the structure of choice for non-resident settlors and in the following paragraphs the main features of the International Trusts Law, as amended, are described.

**Definition of a Cyprus international trust**

The 1992 Law restricted the availability of international trusts to prevent tax avoidance by Cyprus residents. It provided that neither the settlor nor any beneficiary could be a permanent resident of Cyprus, but this is inconsistent with the EU principle of free movement of persons. Under the International Trusts Law, as amended, the restrictions were relaxed and a Cyprus international trust is now defined as a trust, in respect of which:

- the settlor (whether a natural or legal person) is not a resident of Cyprus for the calendar year prior to the creation of the trust;
- at least one of the trustees for the time being is, during the whole duration of the trust, a resident of Cyprus; and
- no beneficiary (whether a natural or legal person) other than a charitable institution is a resident of Cyprus for the calendar year prior to the creation of the trust.

All references to the term ‘resident’ of Cyprus in the amended law now have the same meaning as under the Income Tax Laws, 118(I) 2002 as amended. Moreover, the removal of the prohibition against residence in Cyprus ensures full compliance with EU law regarding the free movement of persons and capital, and freedom of establishment. The removal of the prohibition on ownership of immovable property in Cyprus avoids any difficulties that might otherwise arise if the settlor or any beneficiary were subsequently to take up residence in Cyprus.

**Asset protection features of Cyprus international trusts**

Asset protection trusts ring-fence the settlor’s assets from persons who may have a claim against him or her. They developed as a response to the substantial amounts of damages awarded by juries in civil liability cases in the United States, particularly in medical malpractice claims. Notwithstanding the availability of professional indemnity insurance, some professions still involve a high risk of being on the receiving end of a claim that could be financially disastrous. An asset protection trust adds another layer to the defences. They are also invaluable in a variety of other contexts. In personal life, in light of the substantial awards that courts in certain jurisdictions are making, an asset protection trust may be used to provide added reassurance against claims on breakdown of marriage or civil partnership, particularly for individuals from jurisdictions where prenuptial agreements are ineffective. Many countries have forced heirship provisions in their succession law, reserving a specified portion of the deceased’s estate for relatives, and an asset protection trust may provide a means of regaining freedom of testation.
By their nature, all trusts provide an element of asset protection, by segregating the assets held in trust from the settlor’s general assets, which would be available to satisfy his or her debts or, in the worst-case scenario, would pass to his or her trustee in bankruptcy; however, Cyprus international trusts have several further advantages.

The first is that the International Trusts Law contains a very strong presumption against avoidance of a Cyprus international trust. Unless the court is satisfied that the trust was made with intent to defraud persons who were creditors of the settlor at the time when the payment or transfer of assets was made to the trust, the trust will not be void or voidable, notwithstanding the provisions of any bankruptcy or liquidation laws of Cyprus or any other country and notwithstanding the fact that the trust is voluntary and without consideration or that it is for the benefit of the settlor or his or her family members. The burden of proof of the settlor’s intent to defraud lies with the person seeking to set aside the transfer. Furthermore, any action for avoidance of the trust or setting aside of the transfer must commence no later than two years after the assets were transferred to the trust.

These provisions, particularly the requirement to prove intent to defraud on the part of the settlor, set the bar very high for the claimant trying to set aside a transfer to a Cyprus international trust. Even though the standard of proof is the balance of probabilities, rather than the criminal standard, the claimant must still establish that the trust was more likely than not a fraud. This is a difficult standard to meet in practice and the burden of proving fraud is higher than is usual for civil cases. In practice, the claimant would need very strong evidence to show that the settlor intended to defraud his or her creditors. A claimant domiciled outside the EU without assets in Cyprus would be required to provide security for costs under Order 60 of the Civil Procedure Rules.

Protection against forced heirship and similar claims is provided by Section 3(i) of the 1992 Law, which stipulates that the laws of Cyprus or of any other country relating to inheritance or succession will not in any way affect any disposition of assets to a Cyprus international trust.

The Amending Law of 2012 strengthened these defences by explicitly providing that any question relating to the validity or administration of an international trust or a disposition to an international trust will be determined by the laws of Cyprus without reference to the law of any other jurisdiction. It also makes it clear that the fiduciary powers and duties of trustees, and the powers and duties of any protectors of the trusts are governed exclusively by Cyprus law. Furthermore, it provides that dispositions to a trust may not be challenged on the grounds that they are inconsistent with the laws of another jurisdiction, for example regarding family and succession issues, or on the grounds that the other jurisdiction does not recognise the concept of trusts.

Finally, the Amending Law of 2012 entrenches jurisdictional protection by providing that an international trust containing a choice-of-law clause in favour of Cyprus law is fully protected from unfounded foreign judicial claims as a matter of public policy.

These provisions further reinforce the already formidable asset protection features of the Cyprus international trust.

In another area, Cyprus has a distinct advantage over many other Commonwealth countries, in particular the Caribbean islands and Bermuda, in that it is not a party to the arrangements set out in Section 426(4) and (5) of the Insolvency Act 1986, in terms of which British courts and the courts of certain other jurisdictions are required to assist each other in insolvency cases.
Furthermore, it should also be noted that the Charitable Uses Act 1601 (also known as the Statute of Elizabeth), which invalidates arrangements made to hide assets from future creditors, is expressly negated in Cyprus.

Reserved powers and interests

The Amending Law of 2012 allows the settlor of a trust to reserve powers to himself or herself, to retain a beneficial interest in trust property, or to act as the protector or enforcer of the trust, all without affecting the validity of the trust. The powers that may be reserved are extensive, and include the power to revoke, vary or amend the terms of the trust, to apply any income or capital of the trust property, to act as a director or officer of any corporation wholly or partly owned by the trust, to give binding directions to the trustee in connection with the trust property and to appoint or remove any trustee, enforcer, protector or beneficiary. The settlor may impose a general stipulation that the trustees’ powers are exercisable only with the consent of the settlor or any other person specified in the terms of the trust. The settlor may also reserve the power to change the governing law of the trust.

These provisions, which are similar to the corresponding provisions of Jersey and Guernsey law, give settlors great flexibility to adapt to changes in circumstances or objectives.

Duration of trusts

As was usual at the time, the 1992 Law restricted the maximum life of international trusts to 100 years from the date on which the trust came into existence. Only charitable trusts and non-charitable purpose trusts were allowed to exist in perpetuity. In the intervening period this restriction on the maximum life of trusts came to be seen as a disadvantage of trusts compared with foundations and several jurisdictions have removed any restriction on the duration of trusts.

The Amending Law of 2012 removed the restriction, by providing that from the date the amendment takes effect and subject to the terms of the trust, there will be no limit on the period for which a trust may continue to be valid and enforceable, and no rule against perpetuities or remoteness of vesting or any analogous rule will apply to a trust or to any advancement, appointment, payment or application of property from a trust. Except where the terms of a trust expressly provide to the contrary, no advancement, appointment, payment or application of income or capital from the trust to another trust is invalidated solely by reason of that other trust continuing to be valid and enforceable beyond the date on which the first trust must terminate.

Cyprus international trusts may, therefore, now be established with unlimited duration.

Trustees’ investment powers

The 1992 Law gave trustees freedom in terms of investment powers, merely requiring them to be exercised in accordance with the trust instrument and with the diligence and the prudence that a reasonable person would be expected to exercise when he or she makes investments. The Amending Law of 2012 extended trustees’ investment powers, giving them the same investment powers as those of an absolute owner, allowing them to invest in a broader range of investments for the best interests of the beneficiaries. This brings trustees’ investment powers into line with those of a trustee in England and Wales, and other trust jurisdictions that have followed the English Trustee Act 2000.
The Amending Law of 2012 also removed any doubt regarding trustees’ ability to invest in Cyprus by including a new section specifically empowering trustees to invest in movable and immovable property both in Cyprus and overseas, including shares in companies incorporated in Cyprus.

Confidentiality
Section 11 of the International Trusts Law, as amended, sets out strict confidentiality obligations. It provides that, subject to the terms of the instrument creating the trust, the trustee, protector, enforcer or any other person may not provide any documents or information that disclose the name of the settlor, any of the beneficiaries, or that relate to the trustees’ deliberations regarding the exercise or proposed exercise of their powers and discharge of their duties, or that relate to the financial position of the trust, except in accordance with a court order requiring disclosure. It gives the trustees power to provide a beneficiary with financial statements or any documents or information relating to their receipts and payments that form part of those accounts if the beneficiary has requested them and if, in the trustees’ opinion, disclosure is necessary and in the best interests of the trust. Disclosure is limited to the accounts and the underlying documents and information concerning receipts and payments.

To remove any uncertainty over the consistency of these provisions with Cyprus’s anti-money laundering legislation the Amending Law of 2012 introduced a clause specifically requiring trustees to comply with and implement the relevant provisions of the Prevention and Suppression of Money Laundering Activities Law.

Taxation of Cyprus international trusts
Section 12 of the International Trusts Law as amended provides for a uniform tax regime applicable to all persons on the basis of a tax residency test. In the case of a beneficiary who is resident in Cyprus the worldwide income and profits of the trust are subject to Cyprus tax. In the case of a non-resident beneficiary only income and profits earned from sources within Cyprus are subject to Cyprus tax.

Any beneficiaries who elect to become Cyprus tax residents will be subject to taxation on their worldwide income, like any other Cyprus tax resident. Non-resident beneficiaries will be subject to Cyprus taxation only on any Cyprus-source income.

For trusts that have only resident beneficiaries or only non-resident beneficiaries, the application of these principles is very straightforward. Where a trust has both resident and non-resident beneficiaries, the tax authorities will determine the tax treatment by reference to the scope of rights that the respective beneficiaries have in the trust, as set out in the trust instrument.

Regulation of fiduciary service providers
The Law Regulating Companies Providing Administrative Services and Related Matters of 2012 (Law 196(I) of 2012) as amended (the ASP Law) provides a comprehensive framework for the regulation of fiduciaries, administration businesses and company directors. As well as implementing the Third EU Anti-Money Laundering Directive as it applies to trust and company service providers, it aims to protect users of trust and fiduciary services by putting in place a robust regulatory system and accounting and reporting requirements.

The ASP Law applies to persons and companies providing relevant fiduciary and other corporate services relating to the administration or management of trusts and companies in or from Cyprus, including directorship and secretarial services provided by a legal person,
including acting as an alternate director or secretary, services such as holding of shares of
legal persons in a nominee or trustee capacity, provision of a registered office, services related
to the opening and operation of bank accounts and services for the ownership of financial
assets on behalf of third parties. Providers of relevant services must comply with specified
criteria regarding their professional and academic qualifications, experience and their internal
procedures. Private trustee companies belonging to the beneficiaries of the trust or their close
relatives are outside the scope of the ASP Law provided that they have a representative in
Cyprus who is accessible and accountable for anti-money laundering purposes.

The ASP Law provides that relevant services may be offered only by persons or legal
entities that hold a licence from the Cyprus Securities and Exchange Commission (CySEC)
or who are specifically exempted from the licensing requirement. Lawyers and accountants
who are regulated by their respective regulatory bodies (the Cyprus Bar Association (CBA)
and the Institution of Certified Public Accountants of Cyprus (ICPAC)) are exempt from
the need to obtain a licence but must comply with the other requirements of the ASP Law.

Registration of trusts

When establishing trusts, service providers are required to obtain documentary evidence
of identity of the settlor, the trustees, the beneficiaries (or information on the class of
beneficiaries including the beneficiaries to whom any distributions have been made pursuant
to the trust) and others associated with the trust, as well as information on the activities of the
trust, and keep this information available for inspection by the relevant supervisory body on
request. Service providers must put in place adequate arrangements to segregate and account
for clients’ funds and they must comply fully with all anti-money laundering legislation. They
are subject to continuous monitoring in this regard and CySEC may appoint inspectors to
investigate their affairs.

Each of the supervisory bodies for the purposes of the ASP Law (CySEC, the CBA and
ICPAC) is required to maintain a register of trusts established by the service providers they
regulate, containing the following information:

a. the name of the trust;
b. the name and full address of every trustee at all relevant times;
c. the date of establishment of the trust;
d. the date of any change in the law governing the trust to or from Cyprus law; and
e. the date of termination of the trust.

Any Cyprus-resident trustee of a trust governed by Cyprus law is obliged to notify the relevant
supervisory body of the relevant information within 15 days of the creation of the trust or
the adoption of Cyprus law as the law governing the trust, as applicable. Subsequent changes
in any relevant information, including termination of the trust or a change in the governing
law from Cyprus law, must similarly be notified within 15 days. In the event of termination
of the trust or a change in the governing law from Cyprus law, the register will indicate that
the trust has been terminated and the information on the trust will be kept for five years.

The Prevention and Suppression of Money Laundering Activities Amendment Law of
2018, which implements the provisions of the Fourth EU Anti-Money Laundering Directive,
introduces a requirement for trustees of any express trust governed by Cyprus law or any
other analogous legal arrangement to obtain and hold adequate, accurate and up-to-date
information on beneficial ownership of the trust or arrangement, including the identity of the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries and any other natural person exercising effective control over the trust.

This information must be held in a central register when the trust generates tax consequences in Cyprus. The police, the Customs Department, the Tax Department and the Unit for Combating Money Laundering and Terrorist Financing (MOKAS) and the competent Supervisory Authorities (Cyprus Bar Association, the Central Bank, the Cyprus Securities and Exchange Commission, the Institute of Certified Public Accountants, the Real Estate Registration Council, the National Betting Authority and the National Gambling and Casino Supervisory Authority) will have direct access to the information kept in the register. Obliged entities will also have access for the purposes of customer anti-money laundering due diligence. There is no provision for access by others. Detailed provisions regarding the register are to be set out in secondary legislation.

V  RESIDENCE AND CITIZENSHIP

High net worth individuals are attracted to Cyprus because it gives them the best of all worlds, combining a benign tax and trusts regime without having to sacrifice quality of life or convenience. Cyprus is a highly developed EU Member State offering a high standard of living, excellent physical and institutional infrastructure and communications, and a very low incidence of crime, all in a Mediterranean climate. Furthermore, it offers individuals of good character investing in Cyprus the benefits of accelerated citizenship by naturalisation, with all the benefits of an EU Member State passport.

The Civil Registry Law, 141(I) of 2002 provides for non-Cypriots of full age and capacity to acquire citizenship by naturalisation. Applicants are generally required to have lived in Cyprus for seven years prior to submitting an application, and applications generally take years to process. However, in 2013 the Cyprus government introduced a fast-track procedure that allows qualifying persons investing substantial amounts in qualifying assets in Cyprus to obtain Cypriot citizenship by naturalisation on an accelerated basis, typically within three months. Applicants must own a permanent residence in Cyprus with a value of €500,000 or more excluding VAT and have no criminal record and asset-freezing orders outstanding against them.

The scheme originally required a minimum investment of €3 million but in September 2016 the Council of Ministers approved a number of changes to the programme, making it even more attractive than before and allowing investors to file a stand-alone application on the basis of a €2 million investment plus purchase of residential accommodation in Cyprus at a cost of at least €500,000.

In addition, several other changes were made:

a the parents of the applicant are also entitled to be granted citizenship, provided they purchase a home in Cyprus;

b purchase of undeveloped land is now an eligible form of investment provided that a master plan for the development of the land is submitted;

c purchase of special government bonds is an eligible form of investment, up to a limit of €500,000;

d purchase of units in qualifying investment funds based in Cyprus is now an eligible form of investment;

e bank deposits are no longer an eligible form of investment; and

f applicants are now required to apply for a residence permit along with the main application.
VI OUTLOOK AND CONCLUSIONS

The International Trusts Law of 1992 gave Cyprus a state-of-the-art international trusts regime, with excellent tax mitigation and asset protection features. It was very well received, as evidenced by the large number of trust service providers established in Cyprus, and Cyprus’s continuing popularity with settlors from the former Soviet Union. Over the ensuing 20 years, as other jurisdictions modernised their trusts legislation, Cyprus lost some of its competitive edge, though the basic structure provided by the International Trusts Law remained sound. The 2012 amendments brought the Cyprus international trust regime back to the cutting edge internationally, giving Cyprus the most modern and favourable trust regime in Europe, and providing settlors and beneficiaries with the highest possible degree of protection, confidentiality, flexibility and assurance. This protection has been reinforced by the implementation of an effective, but unobtrusive, regulatory regime, which preserves confidentiality. The accelerated citizenship programme has proved effective in attracting investment into Cyprus, and the ‘non-domiciled’ regime, which exempts investment income from all forms of Cyprus tax, together with income tax exemptions for higher earners and capital gains tax exemptions, is a further incentive. The proposed new law on foundations will make available an alternative structure for those who may prefer that option.
Chapter 16

FINLAND

Lauri Lehmusoja and Stefan Stellato

I INTRODUCTION

Finland is a northern European country with a population of 5.5 million, a substantial portion of which lives in the metropolitan area in the south of the country, including the Finnish capital Helsinki. Finland joined the European Union in 1995 and was among the first Member States to adopt the euro in 1999. Finland’s geographical position as a western European market economy and a stable parliamentary democracy sharing a long border with Russia is unique and has shaped the history of the country. In 2017, Finland celebrated the centenary of its independence from Russia. Finland is now one of the safest and least corrupt countries in the world, with a high standard of living and a high degree of income equality. It also boasts a world-renowned school system, contributing to most Finns having a very good command of English. Finland is the home of a significant Swedish-speaking minority and the country has two official languages, Finnish and Swedish.

The success of the cell phone and networks manufacturer Nokia Corp, along with a number of high-tech companies, was a major factor contributing to a long period of strong economic growth that Finland enjoyed in the 1990s and 2000s. Finland has, on the other hand, suffered heavily from the recent financial crisis, which coincided with a sharp decline in Nokia’s businesses, as well as a downturn in trade with Russia. This combination lead, inter alia, to a very slow recovery in terms of GDP growth and to Finnish long-term debt being downgraded from its previous AAA-rating by all major credit agencies. The government is now struggling with increasing levels of national debt and an ageing population. The government is also particularly busy with the remarkably extensive health, social services and regional government reform, which is expected to enter into force within the next couple of years.

The Finnish economy was dominated by agriculture until the 1950s, and rapid industrialisation and growth took place during the following few decades. Since the 1970s, Finland has been among the wealthiest countries in the world. As the emergence of a modern economy dominated by industry and services is quite recent, wealth is less accumulated than in most other countries. Finland is also a Nordic welfare state, characterised by free market capitalism combined with a significant public sector, large-scale income redistribution and high tax rates. Because of these factors, wealth is quite evenly distributed among Finns and Finland is home to relatively few high net worth individuals (HNWIs).2

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1 Lauri Lehmusoja is a counsel and Stefan Stellato is an associate in the tax group of Hannes Snellman Attorneys Ltd in Helsinki.
2 The former mobile phone manufacturer Nokia (and the Nokia cluster as a whole) generated a handful of HNWIs, but over the past years HNWIs generated by the gaming industry have received more attention.
Despite, for example, a broad network of tax treaties, the Finnish high-tax environment is, perhaps, unlikely to attract HNWIs to Finland. Other factors, such as safety, northern nature, stable institutions, low corruption and a renowned education system are, in this regard, more important assets for Finland.

II TAX

i Recent developments

One issue stands out particularly clearly in the recent developments of Finnish tax law – the ever-increasing disapproval of tax avoidance and planning, as manifested also on an international level by Organisation for Economic Co-operation and Development (OECD) and EU actions against such activities. In addition, the reputational damage to persons and companies engaging in tax avoidance and planning has grown. Finnish persons and companies involved, for instance, in matters concerning the LGT Bank in Liechtenstein or in arrangements published in the ‘Panama Papers’ are likely to agree.

As a main rule, tax-related information is secret, including, for example, rulings and tax returns. However, taxable income and taxes payable (as determined in the annual tax assessment) are public information in Finland. Unsurprisingly, access to this information attracts significant media attention, and each year the media publishes listings on the income and effective tax rates of high-income people and companies. Because of the fact that not all tax-related information is public (e.g., later decisions amending the taxation of a given year remain secret) and that tax-exempt income and income routed to personal holding companies do not show in the statistics, these listings may be somewhat misleading.

The worsening of the general tax atmosphere can also be seen in that the Finnish general anti-avoidance rule (GAAR) is being applied ever more frequently. The GAAR now appears to be engaged in attacking practices that were previously widely considered acceptable. The Tax Administration is, for example, broadly questioning the deductibility of intra-group interest expenses in corporate taxation and closely scrutinising various holding and personal services company arrangements. It also appears that the Tax Administration may begin to challenge certain types of tailored insurance wrappers, a common tax planning strategy.

A working group recently presented its proposals to better align the tax treatment of different forms of investment. These proposals included the abolishment of the possibility to withdraw invested capital from insurance wrappers without triggering taxation and the potential introduction of a share saving account. It is, however, unclear if the proposals will be passed into law.

Another general trend in Finnish taxation over recent years is the increase of both tax rates and progressiveness. To name a few examples, the tax on capital income, which for a long time was proportional, became progressive in 2012. New tax brackets have been added at the high end of the scale for earned income, gift and inheritance tax, although all of these taxes have recently been slightly reduced.

A reverse trend can be discerned in the taxation of corporations – the corporate income tax rate has gradually decreased and the present 20 per cent rate was introduced in 2014. The focus of taxation is also shifting from taxation of income to the taxation of consumption, and the standard VAT rate is 24 per cent. Taxation with underlying environmental or
health-related goals is common, for example, within excise taxation. Finland levied a wealth tax for a long time, until it was eliminated in 2006. At about the same time, the avoir fiscal dividend tax system was abolished because of its incompatibility with EC law.

ii International agreements

Finland has a wide network of bilateral tax treaties. Finnish tax treaties typically follow the OECD Model closely and most of them provide for double taxation relief through the credit method. A number of Finnish tax treaties contain provisions that extend the taxing rights of Finland for a number of years after a Finnish citizen moves abroad.

Finland has recently renegotiated its outdated tax treaties with Germany, Spain and Portugal. The new treaty with Germany has been applied since 2018 and the new treaty with Spain will be applied as of 2019. Renegotiation of the treaties, especially with Spain and Portugal, was the result of increasing media attention towards high-income individuals moving to Spain or Portugal to avoid tax on their private-sector pensions, as the relevant treaty did not allow Finland to tax such pensions. The Finnish government terminated its current tax treaty with Portugal with effect from 2019 to put pressure on the country, where the new treaty has not yet been handed to parliament despite being signed in 2016. Unless Portugal adopts the new treaty soon, a treatyless situation will arise as of 2019.

Finland is a signatory of the Nordic Multilateral Tax Treaty, which is a multilateral double taxation convention largely based on the OECD Model Tax Convention. Finland is also among the countries that signed the OECD Multilateral Instrument (MLI) in June 2017. Finland included most of its tax treaties as covered agreements, but made broad reservations to the applicable provisions. Consequently, it is expected that the most important practical effects of the MLI will be the introduction of the principal purpose test and mandatory arbitration procedure. The MLI will be applied as of 2020 at the earliest.

Finland will have to make significant amendments to its national laws over the upcoming years as a result of the EU’s Anti-Tax Avoidance Directive (ATAD) and its 2017 amendment (ATAD II). Significant amendments are expected especially to the current interest-deduction limitation and controlled foreign corporation (CFC) rules, which are among the rules that must be applied as of 2019.

Finland has an agreement with the US to exchange information under the US Foreign Account Tax Compliance Act. Finland has also agreed on automatic exchange of information in the context of the OECD Common Reporting Standard (CRS), implemented at the EU level through the DAC2 Directive (2014/107/EU). Finland is among the countries that started reporting in 2017. Since 2017, Finland now also requires, based on OECD and EU transfer pricing initiatives, multinational groups with revenues exceeding a certain global threshold to file country-by-country reports.

In 2016, in a case related to the LGT Bank/Liechtenstein tax affair, the Supreme Administrative Court ruled that documents received from a foreign authority may be taken into account as evidence, even if it is possible that the documents were obtained through a criminal act.

3 EU rules on state aid forced Finland to abolish its recently introduced sweets tax, an excise tax, from the beginning of 2017.

4 The signatory countries of the Nordic Multilateral Tax Treaty are Denmark, Finland, Iceland, Norway and Sweden.
**Income tax**

Two categories of tax liability exist in income taxation: unlimited and limited tax liability. People that reside in Finland (as defined in the Income Tax Act) are subject to unlimited tax liability and pay tax on their worldwide income. Conversely, people who do not reside in Finland are subject to limited tax liability and pay Finnish taxes solely on their Finnish-sourced income, as defined in the Income Tax Act.

A three-year rule applies to Finnish citizens when they move abroad. Under the rule, a Finnish citizen is considered a Finnish tax resident during the year of emigration and for the subsequent three calendar years, leading to tax liability for both Finnish and foreign-sourced income. However, if the person establishes, to the satisfaction of the tax authority, that no ‘close ties’ to Finland remain, Finnish tax non-residency (and limited tax liability) may begin before the end of the three-year period.\(^5\)

Taxable income is calculated separately for earned income and capital income. Capital income is income generated through the possession of wealth and earned income is defined as all other income. Earned income is typically salaries, directors’ fees or benefits in kind and is taxable at progressive rates of up to approximately 55 per cent. Capital income is taxable at a rate of 30 per cent up to €30,000 per calendar year and the excess at a rate of 34 per cent.

In some situations, taxation is complicated by the fact that taxable income is assessed separately under three different acts, depending, among others, on if the source of the income is employment, business or farming.\(^6\) Losses from one source of income may not be offset against another source of income, apart from in rare exceptions. The introduction of a *de facto* presumption that the income of a limited liability company is income from business is expected as of 2019.

Capital gains are generally taxable at the capital income tax rate of 30 or 34 per cent. Some capital gains are exempt, including the sale of a house or apartment that has been used as a permanent home for two consecutive years.

The extensive taxation of capital gains creates an incentive for persons with inherent capital gains to move abroad and realise the gains while no longer subject to Finnish unlimited taxation, or at least resident in another state under the applicable tax treaty. However, moving abroad before realising a significant capital gain requires careful examination of the applicable tax treaty and tax law provisions, including the above-mentioned three-year rule.

Interest income is also taxable at the capital income tax rates. However, interest paid on deposits in Finnish bank accounts and Finnish bonds is subject to a final tax at source at a flat rate of 30 per cent. As far as interest expenses are concerned, deductions are generally granted only where interest is paid with an aim to obtain taxable income. The interest on loans to buy a permanent home was, however, fully deductible until 2012, when the deductible portion started a gradual decrease. As of 2019, only 25 per cent of home loan interests will be deductible.

The taxation of dividend income is very complex, and the tax rates range from approximately 7.5 per cent to above 55 per cent. These discrepancies highlight the importance of careful tax analysis, but may also offer significant tax advantages. Examples of factors that may have an impact on the applicable tax rate are whether the company distributing the dividend is listed, the value of the company’s net assets, the place of incorporation and on what basis the amount of the dividend is determined.

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\(^5\) It should be noted that this three-year rule does not apply to foreign citizens.

\(^6\) These acts are the Income Tax Act, the Business Tax Act and the Act on the Taxation of Farm Income.
As far as natural persons resident in Finland are concerned, the least tax is payable when receiving from an unlisted company a dividend that meets two conditions: it equals less than 8 per cent of the shares’ calculated mathematical value and is less than €150,000 in a calendar year. When these requirements are met, 75 per cent of the dividend is exempt and 25 per cent is taxed as capital income, leading to a tax rate of around 7.5 to 8.5 per cent. At the other extreme are, among others, dividends paid in place of wages and dividends paid by companies in non-EU/EEA and non-treaty countries. Such dividends are fully taxable as earned income at progressive tax rates of up to approximately 55 per cent.

Limited liability companies and certain similar types of companies are subject to 20 per cent corporate income tax on their profits. Cross-border restructurings may in some situations trigger exit taxation; for example, where assets are transferred outside the reach of Finnish taxation. In the case of exchange of shares, the tax deferral allowed is forfeited, if a person who has been granted shares in consideration moves his or her residence, as intended in the relevant tax treaty or national laws, outside the EEA within five years after the end of the year in which the exchange of shares was carried out.

Finland introduced a CFC rule in 1995 and an interest-deduction limitation rule in 2014. The latter bars deductions for net interest expenses that exceed 25 per cent of tax-EBITDA on loans between related parties within the business source of income, although there is a safe haven for net interest expenses that do not exceed €500,000. The current CFC and interest limitation rules will have to be tightened significantly to render them compliant with the requirements of the ATAD as of 2019. The ATAD requires, for example, the interest limitation rule to cover all loans within all income sources, with notable effects especially on holding companies and the real estate sector, which have generally been taxed within the personal source of income.

iv Gift and inheritance tax

Inheritance or gift tax is payable, if the place of residence of the decedent or donor, or the place of residence of the beneficiary or donee, was in Finland at the time of death or donation. In addition, tax must be paid on Finnish real property and on shares in any corporate body in which more than 50 per cent of the assets consist in Finnish real property, even if both the decedent or donor and the beneficiary or donee resided overseas. Only inheritances that are at least €20,000 and gifts that are at least €5,000 are subject to tax.

Inheritance tax is assessed on each beneficiary’s net portion of the estate. Tax is payable on portions that are at least €20,000, but widows may deduct an additional €90,000 and minors in immediate lineal descent an additional €60,000 from their portions. The favourable rules, which exempted certain insurance indemnities paid to close relatives up to €35,000 and in the case of a widow up to half or at least €35,000, were abolished with effect from 2018.

For the purposes of both inheritance and gift tax, the value of any rights of possession is deducted from the beneficiary’s portion, if such a special possession has been provided for in a will or a deed of gift. The value of the right of possession is not as such taxable, but income derived from the right of possession constitutes taxable income. For example, the title of a house may be donated to person A, but the donor may retain the right to use the house.

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7 This extended definition of real property is also found in some other tax laws and in tax treaties.
this case, person A is taxed on the value of the house less the value of the possession right (calculated according to a formula) and the donor is taxed only on income received from the right of possession (e.g., rental income).

Both gift and inheritance tax have two brackets – the lower tax bracket I applies to close relatives and the higher tax bracket II applies to more distant relatives and to beneficiaries and donees that are not relatives of the decedent or donor. The taxes are progressive within both brackets. As an example of the applicable rates in 2018 in tax bracket I, the tax payable on an inheritance portion of €200,000 is €21,700. An inheritance portion of €1 million is subject to a tax of €149,700 at the lower limit of €1 million and at 19 per cent on any part exceeding €1 million. In tax bracket II, rates are roughly double those of bracket I.

The Inheritance and Gift Tax Act leaves considerable room for tax planning. It may, for example, be wise to pass down property to a greater number of beneficiaries to multiply recipient-specific allowances and thresholds, but also to mitigate progressivity. The same goals may be obtained by skipping generations by willing or donating property to, for example, grandchildren. Rights of possession are also frequently retained to lower the valuation of the donated property and hence the payable gift tax.

There are, however, rules aimed at curbing tax planning. Gifts received from the same donor during a three-year period are aggregated. Loans with no intention to pay back and sales at less than 75 per cent of fair market value are subject to gift taxation. There is also an exception to the general rule, according to which the donee may use the gift tax value as his or her acquisition cost – if the donee disposes of the gift within one year from receipt, the acquisition cost will be the donor’s original acquisition cost. Also, in inheritance taxation the value for inheritance tax purposes becomes the beneficiary’s or heir’s acquisition cost, but there is no one-year rule, such as the one in gift taxation.

The media regularly brings to the public’s attention cases where people move abroad with the aim to avoid gift or inheritance tax. Finland’s neighbours Sweden and Norway, which levy neither inheritance nor gift tax, are particularly attractive from this point of view. However, among others, the tax provisions concerning Finnish real property and Finnish real estate holding companies place hurdles for such tax planning strategies.

The Income Tax Act and the Inheritance and Gift Tax Act provide for relief for certain transactions that aim at passing a business or a farm to the next generation. The relief is implemented, for example, through favourable valuations in inheritance and gift taxation, non-taxation of capital gains, allowing sales at 50 per cent of fair market value without triggering gift taxation or longer tax payment times. The types of relief depend on the way in which the change of generation is carried out and on whether relief is granted under the Income Tax Act or the Inheritance and Gift Tax Act.

Relief is subject to various conditions, which include that at least 10 per cent of the activity is transferred and the activity is continued by the transferee after the transfer. A further sale of a company, farm or other business that has been transferred to the next

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8 Tax bracket I for gift and inheritance tax purposes includes, among others, the donor’s or the decedent’s spouse or registered partner, any heir in lineal ascent or descent and any heir of the spouse in lineal descent. As a general rule, cohabitants come under tax bracket II, but they may come under tax bracket I, for example, if they have earlier been married or have a child together.

9 Wills may be, partially because of their flexibility, an attractive tool for inheritance tax planning. For example, suspensive conditions that give ownership rights to the beneficiary only after certain conditions are fulfilled have been used to create an interim ownerless period and thus defer the payment of inheritance tax. It should be noted that this strategy has obvious pitfalls.
generation in a transaction enjoying change of generation relief leads to forfeiture of the relief and to a penalty payment if the sale occurs within five years of the purchase agreement or the tax assessment in which the relief was granted. The tax provisions on change of generation transactions are a politically highly sensitive topic in Finland.

v Property and transfer taxes

Owners of real property pay real estate tax, which is typically around 1 per cent of the value of the real estate per year. When acquiring real estate, a transfer tax of 4 per cent is payable by the purchaser. The transfer tax rate applicable to housing and real estate companies is 2 per cent, in which case the tax base also includes certain loans of the company, and 1.6 per cent for other shares. No transfer tax is generally payable on listed shares or assets received as a gift or inheritance.

III SUCCESSION

i Legal implications of marriage, registered partnership and cohabitation

Marriage and registered partnership have almost identical legal effects, the main differences being that the possibilities to take the other partner’s last name and adoption are more limited in registered partnerships. Cohabitation, in turn, does not create any immediate legal rights or obligations. The possibility to conclude new registered partnerships ended in March 2017, when legislation allowing same-sex marriages entered into force. Existing registered partnerships can now be turned into marriages with a notification.

Marriage does not cause changes in the ownership of property. Nor is there liability for debt taken by the other spouse, but there may be joint liability for debt taken for the maintenance of the family. The common home is protected by requiring both spouses’ consent to its sale, even where owned by one spouse alone.

A petition for divorce may be filed by the spouses jointly or by only one of them. The reasons for divorce are not examined. Upon granting a divorce, normally after a reconsideration period of six months, one of the spouses may be ordered to pay maintenance to the other spouse, if deemed equitable.

At divorce, the net marital property is totalled and divided into two in order to determine the share of each spouse. The spouse with less property receives an equalisation payment, which is tax exempt, from the other spouse so that each spouse leaves the marriage

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10 Until 2017, a further sale at a later point was treated favourably: the capital gain was calculated using as the acquisition cost the full fair market value at the time of the generation-shift transfer (and not the actual taxable value that was lowered based on the above-discussed reliefs). This rule was changed as of 2017 and the capital gain is now calculated using as acquisition cost the (lowered) taxable value that was actually applied.

11 One common argument against taxes on inheritances is that they endanger the prerequisites to continue a business, especially where the transferred business has no liquid assets that could be used to pay the tax due.

12 Because of significant similarities, in the text below, references to marriage apply also to registered partnerships.

13 Since 2011, there is a somewhat limited possibility to receive compensation also upon a cohabitation separation if one partner has assisted the other in accumulating property over a long period.
with the same amount of what used to be matrimonial property. However, prenuptial agreements are relatively common and they frequently entirely remove the duty to make equalisation payments.14

ii  Intestacy and wills

Finland is a signatory of the Nordic Convention of 19 November 1934 concerning Inheritance, Testamentary Dispositions and the Administration of Estates of Deceased Persons between Denmark, Finland, Iceland, Norway and Sweden. In 1976, Finland joined the Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions.

As an EU Member State, Regulation No. 650/2012 on international successions is of particular importance for Finland. This Regulation governs issues such as applicable law, recognition and enforcement of decisions and the creation of a European Certificate of Succession. It brings more choice, simplicity and clarity to cross-border successions and is binding on most EU Member States.15

In some situations, gifts and other payments received during the decedent’s lifetime are taken into consideration in determining the size of the estate to be distributed. After a married person passes away, a division of property is carried out between the spouses. Thus, if the decedent’s net assets exceed the net assets of the surviving spouse, the death estate makes an equalisation payment to the surviving spouse. No inheritance or gift tax is due on equalisation payments. A surviving spouse with more net assets than the decedent may decide not to make an equalisation payment to the estate of the deceased person. No division of property is carried out if the spouses’ marital rights in each other’s property have been removed through a prenuptial agreement.

In the case of intestacy, the children inherit the whole estate even if the decedent was married. If there is no spouse and there are no children, the parents inherit everything, and if there are no living parents, the decedent’s brothers and sisters inherit.

A will can be used as a tool to choose the heirs and give them either a share of the estate or a legacy. As a main rule, for a will to be effective, it has to be made in writing and signed in the presence of two witnesses. Direct descendants are protected by a forced heirship regime that gives them the right to claim a reserved portion that equals half of the share that they would have received absent the will. The surviving spouse is protected almost invariably through retention of possession (but not ownership) of the undivided common home.

IV  WEALTH STRUCTURING AND REGULATION

i  Wealth structuring vehicles

Finnish law does not recognise the common law institution of trust.16 In addition, the use of foundations for wealth structuring purposes is very limited, because foundations are typically

14 Prenuptial agreements cover around a third of all marriages and registered partnerships. Some flexibility as to how a prenuptial agreement is drafted is allowed and it is, for example, quite common to provide that the agreement shall apply only at divorce (but not death of a spouse) or that the prenuptial agreement only affects property accumulated before the marriage. In order to be effective, a prenuptial agreement must be concluded in writing, dated, signed, attested and registered by the local register office.
15 Denmark, Ireland and the UK do not participate in the Regulation.
16 There is, however, some case law, e.g., regarding foreign trusts and their treatment in Finnish taxation.
required to have a charitable purpose and they are subject to strict supervision enforced with even criminal sanctions. Limited partnerships, on the other hand, are mainly used by private equity investors and in other circumstances where the features of a transparent entity are desirable.

Thus, the most common vehicle for wealth structuring remains the limited liability company. As the taxation of dividends in the hands of an individual shareholder is affected by the value of the dividend-distributing company’s net assets, accumulating property in a limited liability company is often advantageous from a tax perspective. Setting up a limited liability company is very straightforward and requires a minimum incorporation capital of €2,500. At least one member of the board has to reside within the EU or the EEA, unless a special permission is granted.

Another reason why corporations are an attractive vehicle for accumulating wealth is that invoicing through personal service companies or holding companies, especially in the field of professional services, may to some extent be used as an alternative to receiving the same amount of income as wages. As discussed above, earned income is taxed at rates of up to approximately 55 per cent, whereas the tax burden when charging through a corporation may be more modest – the corporate tax rate is 20 per cent and dividend distributions are often taxed at only 7.5 per cent. Depending on the circumstances, there might not even be a need to distribute dividends, resulting in ulterior tax savings.

The possibilities to use a corporation to mitigate the very heavy taxation of earned income, for example, by medical doctors at private clinics, have been limited through a legislative change in 2010. As a result of the legislative change, the Income Tax Act now provides that dividends determined based on work contribution, instead of share ownership, are fully taxable as earned income. Even before this amendment, companies with only one shareholder could under certain circumstances be disregarded for tax purposes under the GAAR.

As mentioned above, insurance wrappers, resulting in tax deferral, are frequently used for tax planning purposes. They also offer many tax planning opportunities in cross-border situations. In these arrangements, an insurance policy is ‘wrapped’ around the policy owner’s assets (e.g., shares) that are transferred to the insurance company for the lifetime of the policy. However, it appears likely that the Tax Administration may challenge some of these arrangements, especially those involving the use of a tailored insurance wrapper to hold unlisted assets with personal ties to the insurance holder. Also legislative changes to limit the use of insurance wrappers to obtain tax deferral are anticipated.

ii Regulation of financial service providers and prevention of money laundering
Marketing and offering of services in Finland by investment firms and fund managers of UCITS or alternative investment funds require prior registration with the Finnish Financial Supervisory Authority, which is also the supervising authority. When marketing is directed to

17 As noted above, the taxation of dividends in Finland is very complex. Another factor affecting the use of a Finnish holding company is that dividends from unlisted companies within the EU/EEA, regardless of ownership, and dividends from listed companies within the EU/EEA, subject to a holding requirement of at least 10 per cent, are generally tax exempt. There are no similar exemptions if the shares are held by an individual personally.

18 The new provision has encouraged quite creative tax planning schemes to circumvent it.
non-professional investors (retail investors), certain additional requirements, such as providing key investor information documents and the Consumer Protection Act, apply. The definition of a professional client under the Investment Services Act is based on MiFID II requirements. Finnish legislation on the prevention of money laundering is largely based on international standards, which include the EU’s Anti-Money Laundering Directives, which are based on recommendations of the Financial Action Task Force. The 4th Anti-Money Laundering Directive was implemented into Finnish legislation by the recast Act on the Prevention of Money Laundering and Financing of Terrorism (AML Act) and the Act on the Financial Intelligence Unit. Requirements under the AML Act apply to, *inter alia*, investment firms, fund managers, credit institutions and other entities offering financing in Finland. The duties include identification and verification of customers, ongoing monitoring of customer relationships, record-keeping, detecting and analysing suspicious transactions and reporting suspicious transactions to the Financial Intelligence Unit, which operates in connection with the National Bureau of Investigation. Violations are subject to administrative and criminal sanctions, and negligence towards the obligations may lead to corporate criminal liability and criminal liability for individual employees. Money laundering offences are sanctioned in the Penal Code.

V OUTLOOK AND CONCLUSIONS

The continuously increasing exchange of information is a clear trend in Finland. Finland has agreed on automatic exchange of information in the context of the OECD CRS, implemented at the EU level through the DAC2 Directive. Finland took part for the first time in 2017, reporting and receiving information for 2016. It appears that the Finnish authorities already received a substantial amount of information under these arrangements in 2017, and it is likely that this flow of information will lead to investigations concerning the taxpayers affected. In the absence of an effective voluntary disclosure policy, it has been less popular among Finnish taxpayers to disclose unreported overseas assets on a voluntary basis.

As far as tax planning is concerned, the generation-shift reliefs, as well as holding company and personal service company arrangements, may present attractive opportunities, but careful planning is essential, as tax planning is becoming less tolerated than before. The GAAR is being interpreted ever more broadly and new measures against tax planning are introduced. Implementation of OECD Base Erosion and Profit Shifting proposals and EU legislation against tax avoidance and aggressive tax planning, chiefly ATAD and ATAD II, is around the corner. The tax treatment of different forms of investment may be amended in the near future, for example limiting the tax benefits of insurance wrappers. As ever-fewer tax planning alternatives remain available and, for example, because Finland levies inheritance tax, moving abroad may at present be a relatively effective planning strategy.

There has been a small shift from taxation of income to taxation of consumption and the government has signalled that this will continue to be the emphasis. However, this is by its very nature uncertain, as a change in government coalition may bring alterations to this thinking. What is clear is that Finland will remain a high-tax jurisdiction for individuals, but other factors for which Finland is well known, such as institutional stability, low levels of corruption, good education and a clean environment, are also likely to stay.
I INTRODUCTION

France has traditionally been home to individuals of significant wealth as well as one of the most important destinations for foreign investment (including notably real estate investment). The French tax system is becoming, however, less and less attractive and predictable.

Indeed, personal and estate planning for individuals offers fewer opportunities and those that remain are plagued with uncertainty. Moreover, new rules introduced by the preceding and new governments are ever more stringent.

Business immigrants still enjoy significant income and wealth tax exemptions for a limited period of five years, on the condition that they were not tax residents of France during the five years preceding their relocation to France. The downside is that after five years, business immigrants become fully exposed to the French tax system, including to the exit tax (see Section II.v).

If it were not for its tax system, the French system could be regarded as generally protective of individuals, families and their assets. Also, transfer of assets through generations can be structured with flexibility and security. Even the forced heirship rule allows for some planning or may now be circumvented.

Last, it is noteworthy that the general trend in civil law matters is for more room to be given to contracts and less to rigid statutes, hence the current development of private family governance structures.

Divorce law is a complex matter that cannot be summarised in a few sentences. In particular, the area of international divorce requires a good knowledge of the relevant treaties and applicable EU regulations, and more generally, of private international law principles. Division of assets on divorce is a matter where the issue of the applicable matrimonial property regime very often comes into play. Also, one should be aware of the fact that spouses or future spouses cannot contract on the matter of compensatory payments (clean break), the matter being governed by Civil Code principles and subject to the divorce judge’s interpretation of the facts of the matter.

The principal concern therefore is the French tax system, which lately has become so burdensome that France is losing ground in the international tax competition as an attractive place for businesses, entrepreneurs and high net worth individuals.

Indeed, the trend today is for young entrepreneurs to establish themselves and their businesses abroad, for wealthy individuals to leave France and business executives in France and abroad are more and more tempted to exclude France as a candidate for future investment.

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1 Line-Alexa Glotin is a partner at UGGC Avocats. The information in this chapter is accurate as of 2016.
The bottom line is that France is a country where the middle class and the wealthy contribute heavily but are nonetheless generally regarded as abusers of the economic system.

II TAX

i Introduction to personal taxation for individuals

There is no equivalent in France to the common law concept of domicile. Residence is the criteria for liability to tax. Nationality is generally not relevant in the French tax context. It is, however, a criterion that is used in some tax treaties signed by France (tie-breaker rules).

Tax residents of France are subject to: income tax on their worldwide income; and wealth tax, gift tax and inheritance tax on their worldwide assets. Subject to tax treaty, non-residents of France are liable to income tax by reason of their French source income; and wealth tax, gift tax and inheritance tax on their French assets.

Domestic law applies first and foremost to determine residence. Tax treaty provisions apply only in these cases where double taxation arises.

In practice, the revenue considers that a person who is predominantly in France (even for less than 183 days) or whose centre of vital interests is located in France, is a resident of France. The day count is therefore not relevant in many situations and some individuals living outside France, but having interests and properties in France where they spend most of their time must consider the tax implications of those rules with great care.

Personal income tax is calculated according to a progressive bracket system with a marginal rate of 45 per cent above €152,000 on net income (wages, bonus, commissions, industrial or commercial profits, professional fees, rental income, etc.) plus social contribution tax.

An income surtax is due: (1) at the rate of 3 per cent between €250,000 and €500,000 and 4 per cent above €500,000 for a taxpayer who is single; and (2) at a rate of 3 per cent between €500,000 and €1 million and 4 per cent above €1 million for married couples and members of a PACS (civil pact between different or same-sex couples).

Specific personal income tax rates apply when non-cooperative jurisdictions and territories are involved (75 per cent).

In addition to income tax proper, taxable income is subject to social contribution charges at a global rate of 15.5 per cent on passive income (dividends, interest and capital gains), 7.5 per cent on wages and 6.6 per cent on pensions. Thus, the maximum marginal tax rate income can reach 45+3+15 (63 per cent) and could be as much as 75+3+15 (93 per cent).

ii Developments relating to personal taxation for individuals

Liability to French gift or inheritance tax depends, with reference to the time of gift, namely death (transfer), on the tax residence of the donor (deceased); on the tax residence of the donee (heir) or legatee; and on the location of the assets for tax purposes (which may be different than for civil law purposes). Hence, a careful analysis of the assets’ nature and location has to be made.

As between parents and direct descendants, the tax is calculated in accordance with a brackets system. The marginal rate is 45 per cent above €1.805 million, subject to a basis reduction of €100,000, available every 15 years.

There is no inheritance tax between spouses or members of a PACS.

Lifetime gifts between those couples are subject to tax at the marginal rate of 45 per cent above €1.805 million subject to a basis reduction of €80,000.

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Other rules apply to brothers and sisters (45 per cent above €24,000) and non-relatives (60 per cent).

Transfer of business assets enjoys a favourable tax regime depending on the nature of the business. Full or partial exemption applies, one of them consisting in applying a 75 per cent rebate for the purpose of calculating the gift or inheritance tax basis.

### iii Issues relating to cross-border structuring

Private clients’ estate planning in a cross-border environment necessitates that one consider issues such as:

a. testamentary freedom;
b. surviving spouse and family members’ protection;
c. asset protection and transfer to the next generation;
d. family governance and control; and
e. inheritance, income tax and wealth tax planning.

### iv Regulatory issues

Quite aside from the issue of taxation, privacy in financial matters is nowadays non-existent. Indeed, beyond KYC rules as they are now applied throughout the world, the personal details of owners of French assets, movable or immovable, need to be disclosed to satisfy the requirements of our tax laws, notably in relation to the ‘3 per cent tax’, trustees reporting obligations and National Registry, wealth tax, income tax, gift and inheritance tax. Owning assets through French or offshore vehicles is not a solution as this usually attracts even more confiscatory taxes.

### v Issues affecting entrepreneurs at the proprietor level

The high level of social charges and taxes and the lack of flexibility of our labour laws are also severely affecting the situation of entrepreneurs in France.

In another respect, the exit tax regime has a very significant impact on French entrepreneurs, especially for those who need international mobility. The exit tax provides that, subject to specific deferral rules, an individual who was a resident of France for income tax purposes during the six years preceding the exit date will be subject to exit tax on latent gains pertaining to direct or indirect participations (crystallised on the day preceding the exit date), to the extent that, alone or together with other members of the household, the individual’s participation represents 50 per cent of the annual profits or €800,000, irrespective of whether the entity is French, provided only that it is subject to corporate tax or an equivalent tax.

An automatic payment deferral (without collateral) of the income tax component is available if the taxpayer transfers his or her residence from France to another EU Member State or EEA Member State, provided that country has signed an administrative assistance agreement or mutual assistance agreement with France. Payment deferral may be also granted in other situations (e.g., transfer of residence for professional reasons).

### III SUCCESSION

### i Introduction to succession

One of the most notable differences between the common law and civil code systems in the area of the law that will be reviewed here is that, generally, civil law systems do not recognise
the concept of ‘estate’. This is true in France. The nearest conceptual equivalent is the notion of *masse successoriale*, which refers to the whole of the assets and liabilities of the deceased at the time of death.

Under French inheritance civil law, the conceptual approach is that the estate of the deceased passes directly to his or her heirs at the very moment of death.

Another difference between the two legal systems is the existence under most civil law systems of a limitation on testamentary freedom.

In France, issue of the deceased and, in the absence of issue, certain close relatives and, in most cases, the deceased’s surviving spouse, enjoy special protection by operation of law, the effect of which is to guarantee that they receive a set portion of the estate depending on the number of children of the deceased, if any, as follows: if there is one child, the reserved portion is half; two children, two-thirds; and three or more children, three-quarters. In the event a child dies leaving issue, then the same rules apply per stirpes. In the absence of children, another reserve rule applies to parents, depending on whether there are survivors in one or two ascending lines. In private international law terms, the EU Regulation No. 650/2012 on International Successions, adopted in June 2012, and which applies to successions opened since 17 August 2015, avoids the fragmentation of successions and enables people living in the EU to organise their succession in advance and guarantees the rights of heirs and legatees. Since that date, the succession is subject to a single law: that of the nationality of the deceased or of his or her last domicile.

The regulation provides a European certificate of succession, which will constitute proof of the capacity of heir or legatee and of the powers of the executors of wills or third-party administrators.

**ii Key legislative or case law changes affecting succession**

Under the Civil Code it is now possible for an individual who wishes to plan for the time he or she is no longer alive, to agree separately with one, several or all reserve heirs that the latter waive their right to challenge violations of their reserved portion. This opens the way for transfers of estate assets in excess of the free portion, to the extent of the rights that the relevant heir or heirs have waived. However, this can only be done by written deed under the strictest conditions of form, which notably involve the presence of two French notaries. Only those reserve heirs that are of age can enter into one of those agreements. This waiver is not a taxable event excepting a modest stamp duty.

In addition to the foregoing, it is also now permissible for a person who is planning ahead for his or her succession to delay the moment when the heir has access to his or her share in the estate, for instance when the heir is a minor or needs to finish his or her education. This can be achieved by way of a special deed signed in the presence of a notary. This is known as a power of attorney with posthumous effect, which survives the death of the principal.

Under such a power of attorney, the principal can entrust to any person, including a legal entity, the management of certain designated assets for a limited duration (two or five years, depending on the circumstances, renewable by court order). The power of attorney must be precise in the description of the agent’s powers and must designate the heir or heirs with respect to whom the document is written.

Another development in our law now makes it permissible for an individual, instead of transferring all or part of the future succession assets unconditionally, to make a lifetime gift or a bequest subject to the condition that:
The tax system applicable to gradual and residual gifts and bequests is quite complex but attractive.

### iii Cross-border developments

#### Transnational giving

As regards international gifts, French domestic law provides for very limited flexibility in terms of permitting tax deductible gifts from a French tax resident to a foreign philanthropic body, except (rarely) when a treaty provides for more favourable rules or when the charity is situated in the European Union.4

Concerning the Brexit vote, the tax treatment of the gifts made by EU donors to UK charities is yet to be confirmed.

### IV WEALTH STRUCTURING AND REGULATION

#### i Commonly used vehicles for wealth structuring

Vehicles appropriate for wealth structuring depend mainly on the jurisdiction of residence of the owner and on applicable tax treaty provisions, if any. French residents generally opt for direct detention of their assets or through a civil law company and are keen on life insurance products. Business assets are generally owned through corporations, frequently European corporations. Trusts and family foundations have been used by individuals and families in recent decades, but the new law against trusts introduced by the previous government has put a stop to that. This has generated huge difficulties for those families whose assets were structured on the basis of fiduciary relationships, even for those families that were established in common law high-tax jurisdictions.

The traditional vehicles used for planning in a French context are the following.

#### Civil companies

France does not have partnerships properly speaking but civil companies (as well as other types of structures), which operate very much as partnerships. Civil companies are transparent for civil law purposes and semi-transparent for tax purposes.

By way of example, real estate may be held through a real estate investment company, commonly known as an SCI. The SCI share value can therefore be reduced by bona fide bank loans (but no longer by shareholder loans), provided such bank loans were taken out for the purpose of purchasing the property or with respect to structural work in the property.

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2 Articles 1057 et seq.
3 Articles 1048 et seq.
4 C-318/07 Hein Persche, 27 January 2009.
Life insurance

Life insurance products provided they are EU-law compliant, offer a solution to reduce the scope of application of forced heirship rules. Indeed, under the Insurance Code, monies paid to a beneficiary on the occasion of the death of the owner of the policy are excluded from the succession of the deceased, which means in particular that they are not subject to forced heirship rules.

However, this freedom is subject to a rule of reason that was elaborated in case law, so that great prudence must be exercised if the sums invested as premiums in life insurance exceed the likely value of the free portion on the death of the policyholder.

ii Legal and tax treatment of commonly used vehicles

France does not have a trust law of its own. It signed, but did not ratify, the 1985 Hague Convention on the Recognition of Trusts; however, France, to a large extent, recognises foreign trusts under its own principles of private international law. Indeed, under such rules, a foreign trust should be recognised as a fact, subject to proper evidence being provided.

In addition, for several years, certain French laws have referred directly to trusts: Article 120(9), Article 123 bis and Article 990 D of the Tax Code.

French courts have also recognised foreign trusts as a specific legal concept that should be recognised as such. Since 2011, a trust is now fully transparent for tax purposes, notably wealth tax, gift tax and inheritance tax. As a result, owning French assets, especially French properties through a trust, requires filing of information with the French revenue on a yearly basis in regard to the fair market value of the property and the name of the ultimate beneficiary. Failing that, a 3 per cent tax is assessed on the fair market value of the underlying property and is payable each year. In some cases the trustee may have to pay penalties of 12.5 per cent of the trust assets. A national registry listing trusts involving residents of France or French assets is now in place and records the personal details of settlors, beneficiaries and trustees, as well as the annual value of the trust assets. How accessible it is to the public is debatable, but in any case, it is at the disposition of the French tax administration.

Life insurance

Life insurance provides protection against income tax while the funds remain invested, as well as significant income tax reductions when the owner of the policy decides to withdraw funds. Life insurance can also be used as a planning tool to reduce exposure to wealth tax.

Last, sums passing to an insurance beneficiary on the death of the owner are not subject to inheritance tax (except as regards premiums paid by the policyholder after his or her 70th birthday), but rather to a flat 20 per cent tax up to €700,000 and 31.25 per cent above that amount, assuming that the share received by each beneficiary exceeds €152,500. This rate applies irrespective of whether the policyholder is a French tax resident or not.

iii Key aspects of regulation of service providers dealing with private wealth

Anti-money laundering regime

In France, subject to the following, all transactions suspected of involving money laundering or terrorist financing are reported to a ‘cell’ of the Ministries of Finance and Budget: the Intelligence Processing and Action Against Clandestine Financial Circuits cell, TRACFIN.

France has implemented the Third EU Money Laundering Directive by way of an Ordinance dated 30 January 2009 and subsequent implementation decrees.
French lawyers do not report directly to TRACFIN. Rather they must declare any suspicions of money laundering to the president of the relevant bar. The president then passes on such declarations to TRACFIN, unless he or she considers the suspicions to be unfounded.

In addition, French lawyers are, to an extent, exempted from certain obligations under anti-money laundering laws when they act in the context of legal proceedings to defend a client or provide advice in the interest of the defence of a client, excepting naturally the case of advice that would place the lawyer in the position of an accomplice.

**EU Savings Tax Directive**

The Savings Tax Directive establishes a system of declaration of savings income paid to non-resident investors to facilitate taxation in the Member State where the beneficial owner resides. France opted for the systematic declaration approach.

On regulatory matters it is worth noting that beyond the modernisation of a number of bilateral treaties (e.g., with the United Kingdom, Luxembourg, Belgium and Switzerland), France has entered into a number of tax information exchange agreements, which, subject to some specifications, are in line with Article 26 of the OECD Model, notably with Andorra, Anguilla, the British Virgin Islands, Belize, Brunei, the Cayman Islands, the Cook Islands, Costa Rica, Dominica, Gibraltar, Guernsey, Liberia, Liechtenstein, the Isle of Man, Jersey, the Netherlands Antilles, San Marino and Uruguay.

**EU Foreign Account Tax Compliance Act**

New legislation similar to the US Foreign Account Tax Compliance Act is in force in the EU territory and in France, submitting financial institutions to annual or occasional reporting obligations to the EU tax authorities regarding individuals owning, directly or indirectly, bank accounts or financial investments.

French internal rules also provide strict controls and substantial penalties for hidden bank accounts.

V OUTLOOK AND CONCLUSIONS

Owing to the budget deficit, the future remains bleak. The past and present governments have increased existing tax rates; however, the future government may decrease them.

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5 In November 2013, the United States and France signed a bilateral agreement requiring French banks to report to the French government information about their US account holders. The government of France will forward that information to the Internal Revenue Service and in return the Internal Revenue Service will provide similar information to France about French account holders at US financial institutions.
I INTRODUCTION

Private wealth and private client law in Germany is characterised by a high number of tax and legal regulations on the one hand and a high level of judicial review on the other. Not only the civil and finance courts, but also the state and federal constitutional courts, ensure the consistent and proportionate application of German civil and tax law.

In recent decades, private wealth and family-owned enterprises have been growing. Accordingly, private wealth and private client law in Germany primarily deals with individuals living in Germany and German family-owned companies structuring assets in Germany and other jurisdictions.

II TAX

i Introduction

Unlimited tax liability in Germany is determined by the concept of residence for both income tax and inheritance and gift tax purposes. Residence is assessed using objective criteria. An individual is a German resident if he or she has either a permanent home or a habitual abode in Germany. The resident individual’s worldwide income or assets are subject to income tax, as well as inheritance and gift tax. The concept of domicile, however, is not recognised by German law.

With regard to income tax, there is a progressive tax rate ranging from 14 to 45 per cent. Currently, an additional solidarity surcharge of 5.5 per cent of the tax due is still being levied. This surcharge was intended to finance the German reunification of 1990. Recently, the government decided on the gradual abolition of the surcharge, with the aim of having it completely abolished by 2021; however, high-income earners will not benefit from this tax relief. As mentioned, income tax is levied on the worldwide income of residents. Non-residents pay tax on income from German sources (e.g., income effectively connected with a permanent establishment in Germany, income from employment in Germany (including self-employment), income from German real estate or dividends and capital gains from German companies in cases of a substantial shareholding). Non-residents do not pay income tax on non-business interest income. Income from capital investments (e.g., dividends) is subject to withholding tax at a flat rate of 25 per cent plus the solidarity surcharge. A tax treaty may allow a partial refund.
Concerning inheritance and gift tax, each successor or donee (hereinafter both referred to as transferee) is liable for the tax on the value of the assets received, regardless of his or her personal wealth. The inheritance and gift tax rates range from 7 to 50 per cent, depending on the relationship between the deceased or donor (hereinafter both referred to as transferor) and the transferee, and on the value of the assets received. Spouses and descendants pay inheritance and gift tax at a rate of 7 to 30 per cent. Spouses receive a personal allowance of €500,000 and a maintenance allowance of up to a maximum of €256,000. Children receive a personal allowance of €400,000 and an age-dependent maintenance allowance of up to €52,000; grandchildren receive a personal allowance of €200,000. Transfers between most other relatives are taxed at a rate of 15 to 43 per cent. Between unrelated persons, the applicable tax rate is 30 or 50 per cent (for a transfer of more than €6 million).

Unlimited tax liability is triggered if either the transferor or the transferee is resident in Germany, regardless of whether the assets received are effectively connected to Germany. If neither the transferor nor the transferee is resident, inheritance and gift tax is only due on certain assets situated in Germany (e.g., real estate and business property). The transfer of a German bank account between non-residents generally does not trigger inheritance or gift tax.

Besides income tax and inheritance and gift tax, only a few other taxes are relevant for private clients. A real estate transfer tax with different regional rates ranging from 3.5 to 6.5 per cent applies to the acquisition of real estate or a substantial shareholding (at least 95 per cent) in a company holding real estate. Furthermore, real estate tax is levied annually and is calculated on the basis of rates determined by the local authorities, and property values, which were last assessed in 1964 or 1935. However, the German Federal Constitutional Court held that these obsolete valuation methods are inconsistent with the constitutional principle of equality of taxation. The reform, which has now become mandatory, could result in a significant increase of the tax burden in the future. Wealth tax has not been levied in Germany since 1997.

As a result of European directive requirements, the German government is currently making efforts to introduce an obligation to report certain tax planning arrangements to the tax authorities. This may not only affect tax advisers, but also taxpayers themselves. The details of the implementation in Germany are still pending.

ii Taxation of business assets under the Inheritance and Gift Tax Act

The inheritance tax law has been reformed several times, most recently in 2016. Exemptions of the Inheritance and Gift Tax Act for business assets are still widely available. The transferee may choose between a basic relief and an optional relief. According to the basic relief, 85 per cent of the business assets do not form part of the tax base and the remaining 15 per cent only are taxed. If the taxpayer chooses the optional relief, 100 per cent of the business assets are not considered part of the tax base. The relief is, however, conditional upon the continuing operation of the business for a certain amount of time (retention period) and the preservation of jobs. The retention period amounts to five years for the basic relief and seven years for the optional relief. Regarding the preservation of jobs, depending on the relief model chosen and the number of employees, after the retention period, the total payroll has to amount to at least 250 to 700 per cent of the payroll before the transfer.

Furthermore, business assets can only benefit from the relief as far as they do not constitute passive non-operating assets. Passive non-operating assets are, generally speaking,
leased real estate, minority shareholdings of 25 per cent or less, securities, certain moveables like artworks, antique cars and yachts, and liquid funds if they exceed, after deduction of debt, 15 per cent of the business’ total value.

The passive non-operating assets are fully taxable at the regular rate, so far as their value exceeds 10 per cent of the total business assets (the contamination clause). In extreme cases, if the passive non-operating assets equal 90 per cent or more of the value of the whole business, the remaining potentially tax-privileged assets of up to 10 per cent are excluded from all relief too in order to avoid any misuse. ‘New passive non-operating assets’ (i.e., those assets that were contributed to the business assets within a period of two years before the relevant transfer) are completely excluded from any form of relief.

In contrast to before 1 July 2016, relief can no longer be claimed independently from the value of the business assets transferred. If the value of the assets exceeds €26 million, the transferee may choose between two relief models: an ablation model or an economic needs test. According to the ablation model, the extent of relief is reduced by 1 per cent for each €750,000 in company value exceeding €26 million. The result is, that there is no longer any relief for acquisitions of approximately €90 million. The economic needs test, on the other hand, focuses on the transferee as a person and examines his or her assets. Out of his or her entire non-exempt assets after the transfer, the transferee is required to spend up to 50 per cent for the taxes due on the transferred business assets. Only if the 50 per cent of assets are not sufficient will an exemption from inheritance tax be considered upon request. Finally, it is noteworthy that the reform introduced the possibility of an advance deduction for family companies whose articles of association contain clauses typical for such family companies. However, this is only applicable if the provisions in the articles of association were already incorporated two years before the relevant transfer and if they are not revoked for 20 years thereafter. Therefore, it is highly recommended that family companies examine their articles of association and incorporate the appropriate clauses, if they are not in place already.

### iii Tax treatment of trusts

Trusts are generally not recognised in Germany (see Section IV.iii). Trusts can, however, trigger inheritance and gift tax in several ways. The establishment of a trust by residents (see Section II.i) or of a trust comprising assets located in Germany is considered to be a transfer of assets that is taxable in accordance with the Inheritance and Gift Tax Act. Distributions to beneficiaries during the trust period or on the trust’s dissolution may trigger income tax and gift tax as well, if the beneficiary is a German resident or if German situs assets are distributed. The relationship between gift tax on the one hand and income tax on the other with regard to trust distributions has not yet been ultimately clarified by the courts.

In addition, corporate tax can be triggered if income is received by a foreign trust from German sources. The worldwide income of a foreign trust may be subject to corporate tax if the trust’s management is in Germany and if certain other conditions are met; for example, if the effective management of a trust is vested with a trustee resident in Germany.

Undistributed income received by a foreign trust can be attributed to the settlor or the beneficiaries if they are German residents. In this case, it can be subject to the settlor’s or the beneficiary’s personal income tax.
CFC rules in Germany – Sections 7 to 14 of the Foreign Tax Act

Taxation in Germany generally cannot be avoided by establishing a foreign entity in a low-tax country. The German rules for the taxation of controlled foreign companies (CFCs) meanwhile have an extensive scope of application. The CFC rules are settled in Sections 7–14 of the Foreign Tax Act (AStG).

These CFC rules extend the unlimited tax liability of residents to certain undistributed income of foreign corporations. The income may be attributed to domestic shareholders. The additional taxation under the CFC rules generally requires a substantial shareholding of German residents of more than 50 per cent of the corporation’s shares (in certain cases, 1 per cent may suffice). The foreign corporation has to be an intermediate company, which receives passive or tainted income instead of income from its own business activities. Passive income is defined negatively by a list of active income in Section 8 of the AStG. Cumulatively, this passive income has to be subject to low tax rates of less than 25 per cent. Income that meets both criteria is added to a resident individual’s income, to the extent to which the individual holds shares in the corporation. The taxable person can choose whether the taxes paid on income received from an intermediate company in a foreign country will be deducted from the amount subject to the additional taxation in Germany or whether the foreign taxes shall be credited against the additional taxes levied in Germany. In most cases, the second alternative is advantageous for the taxable person.

A foreign corporation is not, however, supposed to be an intermediate company if, inter alia, its effective place of management or statutory seat is located in a Member State of the EU or the European Economic Area and if the corporation carries out substantial economic activities.

Changes to the CFC rules are also expected in the foreseeable future. Sections 7 to 14 of the AStG are currently being revised by a special task force of the German tax authorities with the aim to modernise, as some of the regulations are over 30 years old. Adjustments are, furthermore, required with regard to the European Anti Tax Avoidance Directive.

III SUCCESSION

i Wills

According to Section 2064 et seq. and 2229 et seq. of the German Civil Code, there are two valid forms of wills: the holographic and the public will. The holographic will has to be handwritten, dated and signed by the testator. The public will has to be signed before and certified by a notary public. Neither form of will requires a witness.

A testator can also enter into a contract of succession with another person or set up a joint will with his or her spouse or civil partner. A contract of succession must be signed before and certified by a notary public; a handwritten contract does not meet the formal requirements.

By making a will, an individual can choose his or her heirs and state what share each heir receives subject to forced heirship rules. Additionally, an individual can make a legacy; that is, a person can be empowered to make a claim against the heirs, without being an heir himself or herself. This claim can be for an amount of money, a share of the deceased’s estate, an item or anything else.

Wills made in a foreign jurisdiction can be valid in Germany. Germany recognises the HCCH Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions 1961. Additionally, formal requirements for a will are laid down in Article 27...
of the EU Succession Regulation. A will is valid if it complies with the law of the state where the testator made the will, the state of the testator’s nationality or residence or, in the case of real estate, the location of the assets. Foreign grants and probates are not recognised. An heir must ask the competent probate court to issue a German certificate of inheritance.

ii Intestacy and forced heirship regime

If an individual dies intestate, intestacy rules apply. Under the intestacy rules, the deceased’s estate is distributed among his or her relatives and spouse or civil partner in accordance with a strict order of succession. Children and their descendants constitute the first category, followed by parents and their descendants, grandparents and their descendants, and great-grandparents and their descendants. Relatives within a particular category inherit in equal shares (succession per stirpes). Where German law applies, the surviving spouse or civil partner also has a right of inheritance, determined by the matrimonial regime. Within a community of accrued gains, the surviving spouse or civil partner gets at least 50 per cent of the estate. If the deceased and his or her spouse or civil partner chose separation of property or community of property as their matrimonial regime, the surviving spouse or civil partner receives at least 25 per cent of the inheritance.

There is a forced heirship regime under which the descendants, the spouse or civil partner and the parents of the deceased are entitled to make a claim for a compulsory share of the deceased’s estate, if they are excluded from the testator’s will or if the share granted to them is less than their compulsory share. A relative’s compulsory share generally amounts to 50 per cent of the value of that relative’s hypothetical share on intestacy. It is a monetary claim and not a claim for a share of the estate. The compulsory share comprises all assets governed by German succession law (regardless of the beneficiary’s residence). Therefore, the forced heirship regime can be avoided by acquiring assets that are situated abroad and that German succession law does not govern. The forced heir can renounce his or her right to his or her compulsory share during the testator’s lifetime by signing a contract with the testator before a notary public. If the testator has died, a forced heir can also refrain from claiming his or her compulsory share.

iii Conflict of laws rules

Under old conflict of laws rules in Germany, the applicable succession law was that of the deceased’s nationality. If the deceased was a foreign national, German succession law applied only if the law of the deceased’s nationality provided for a reference back to Germany (renvoi). This could be the case if the deceased was domiciled in Germany, if the deceased’s habitual abode was in Germany or if the deceased held property or assets in Germany on the date of his or her death.

For successions as of 17 August 2015, new conflict of laws rules apply because of the EU Succession Regulation. They are valid in all EU Member States except Denmark, Ireland and the United Kingdom. The Regulation is not only applicable to cross-border inheritances within the EU, but also to cases with links to third countries (e.g., US citizens with their habitual abode in a Member State). According to the Regulation, the deceased’s habitual abode at the time of his or her death instead of his or her nationality is relevant for the question of which succession law is applicable. If it is obvious that the deceased had a closer relationship to another state, that state’s law will apply under certain circumstances. There is, however, the opportunity to opt for the succession law of an individual’s nationality through a will, a joint will or by conclusion of an agreement regarding succession.
In addition, provisions on legal jurisdiction, recognition and enforcement of decisions and authentic instruments and on the European Certificate of Succession are part of the Regulation. As a general rule, the jurisdiction will be determined by the habitual abode at the time of the individual’s death.

The EU Succession Regulation is not applicable to trusts, hence the respective national conflict of law regime applies.

IV WEALTH STRUCTURING AND REGULATION

i Commonly used structures: corporations and partnerships

Two structures are commonly used in Germany to hold assets: corporations and partnerships.

A corporation is subject to German corporate tax on its worldwide income if its effective place of management or statutory seat is located in Germany. The corporate tax amounts to 15 per cent plus the solidarity surcharge (see Section II.i). In addition to corporate tax, a trade tax is also levied. The trade tax due depends on the rates determined by the local authorities. A participation exemption may apply, however, for dividends and capital gains. Profits distributed to shareholders of the corporation are subject to withholding tax at a flat rate of 25 per cent plus the solidarity surcharge.

A foreign corporation with income from German sources might be subject to German corporate tax. If a foreign corporation has a branch in Germany that constitutes a permanent establishment, the corporation will be subject to German corporate tax and trade tax on all income effectively connected to this permanent establishment.

Partnerships are fiscally transparent in Germany for income tax purposes. The partners are subject to income tax at their individual tax rates plus the solidarity surcharge. If the partnership is engaged in trade or business, the partnership itself is subject to trade tax. Trade tax levied from the partnership is (to a large extent) credited against the income tax of the partners if they are individuals.

ii Foundations

Foundations in Germany can be established either as charitable foundations or as family foundations. Charitable foundations are tax privileged. Recognition as a charitable foundation requires that the foundation’s activities are dedicated to the altruistic advancement of the general public in material, spiritual or moral respects. These purposes must be pursued altruistically, exclusively and directly. A charitable foundation may, however, use a third of its income for the maintenance of the founder and his or her family. The formation of a charitable foundation neither triggers any inheritance or gift tax, nor real estate transfer tax if real property is transferred gratuitously to the foundation. A charitable foundation is released from almost every current form of taxation, especially corporate tax and trade tax.

In contrast, a family foundation is not tax-privileged. It is conducted for the personal benefit and the advancement of one or more families. The formation of a family foundation and later donations to the foundation generally trigger inheritance and gift tax. The current taxation of a family foundation generally complies with the taxation of other legal persons. A family foundation can, however, receive income not only from trade or business but any type of income. In addition, only family foundations are liable for a substitute inheritance tax. This special tax accrues every 30 years. Moreover, distributions to beneficiaries are subject to income tax. The liquidation of a family foundation leads to an acquisition of assets on the
level of the beneficiaries. This acquisition is treated as a lifetime gift. Therefore, it is subject to
gift tax. Income tax may be triggered as well. The classification of the tax bracket depends on
the relationship between the founder and the beneficiary.

In contrast to German family foundations, foreign family foundations are not liable
to pay substitute inheritance tax. However, the undistributed income of a foreign family
foundation may be attributed to the personal income of the founder or the beneficiaries
if they are resident for tax purposes in Germany (Section 15 AStG). This does not apply
to family foundations that have their seat in a Member State of the EU or the European
Economic Area, if the foundation’s assets are legally and effectively separated from the
beneficiaries’ property and that a treaty regarding mutual administrative assistance exists
between Germany and the state in which the foundation has its seat. These conditions have
to be satisfied cumulatively.

iii Trusts

Neither domestic nor foreign trusts are recognised in Germany. Germany does not have its
own trust law. Germany did not ratify the HCCH Convention on the Law applicable to
Trusts and on their Recognition 1985. Therefore, German property law does not recognise
the transfer of assets located in Germany to a trust. In these circumstances, the terms of a
trust are interpreted in accordance with German law for civil law and tax purposes.

Where assets governed by foreign property law have been transferred to an irrevocable
trust effectively formed under foreign trust law, the trust can shelter these assets from the
settlor’s or beneficiary’s creditors. German courts generally do not recognise claims against
trust assets on the dissolution of a marriage or partnership after 10 years from the date of
the transfer.

Foreign trusts are disadvantaged in terms of tax issues when they are established or
when distributions to beneficiaries are made (see Section II.iii).

V OUTLOOK AND CONCLUSIONS

The German legal and tax system offers some flexibility for private wealth and estate planning.
If structured appropriately, the taxpayer can take advantage of certain relief mechanisms for
the succession in family-owned businesses. In particular, flexibility was gained when the EU
Succession Regulation came into effect.

Usually, corporations and partnerships are used to structure assets and transfer them
to the next generation. Family foundations and charitable foundations may be considered
an alternative instrument in estate planning from time to time. Trusts, however, are not
recognised in Germany. In comparison with corporations and foundations, they are
disadvantaged if beneficiaries of a foreign trust have their permanent home or their habitual
abode in Germany.
Chapter 19

GIBRALTAR

Peter Montegriffo QC

I  INTRODUCTION

Gibraltar is a self-governing, economically diversified and multicultural British Overseas Territory that joined the European Union (subject to a number of important derogations) with the UK in 1973. It voted in the Brexit referendum of 2016 (strongly favouring the remain option). Gibraltar has been included in the negotiating process seeking to define the UK and Gibraltar’s new relationship with the EU.

The Gibraltarians are British nationals, bilingual in English and Spanish and fiercely loyal to the British Crown. Elections to Gibraltar’s parliament take place every four years and deliver a ‘government’ and an ‘opposition’ in the style of Westminster.

Gibraltar has historically enjoyed the trading and commercial opportunities that derive from its strategic location at the entrance of the Mediterranean and unique status. While Gibraltar is a small jurisdiction, it boasts a diversified trading, tourist, shipping, e-commerce and financial services economy. Additionally, on 1 January 2018, Gibraltar became one of the first jurisdictions to enact specific distributed ledger technology regulations (with token regulations expected to be released shortly), marking a significant milestone for Gibraltar in the fintech industry.

Given Gibraltar’s access to the EU single market, its policy priority in financial services has been to develop as an onshore centre. There has, therefore, been an increasing focus on substance and regulatory accountability. This is reflected in the corporate and private wealth management arrangements established for international clients.

Gibraltar attracts wealthy individuals for both private client services and residence, given its lifestyle and taxation offering. It is extensively used as a tax-neutral platform for the planning, structuring and preservation of private wealth and is home to a number of important family offices.

Gibraltar operates a territoriality-based tax system. Income tax is charged on income that accrues in or derives from Gibraltar. The Income Tax Act 2010 (the 2010 Act) was designed to introduce a competitive, internationally compliant tax regime. It provides for corporate taxes on profits at 10 per cent.

Gibraltar has no wealth taxes or any taxes on capital gains, inheritance or gifts. Gibraltar does not levy value added tax (VAT) and is exempt from the provisions of the Customs
Union. This has provided a number of interesting planning opportunities. It represents a real advantage to companies based in Gibraltar that can access services externally without incurring any liability to VAT.

II  TAX

i  Introduction

The basis on which tax is determined is whether income accrues in, or is derived from Gibraltar, regardless of the residence of the recipient.

The test for determining whether income accrues in, or is derived from Gibraltar follows the established jurisprudence set out in various leading UK Privy Council decisions (binding in Gibraltar in the absence of any Gibraltar cases) and related authorities.\(^2\) Regard must, therefore, be had to the whole of the activities undertaken, where these take place and which activities give rise to the income in question.

Section 74 of the 2010 Act makes clear, however, that in the case of businesses that undertake licensed and regulated activities in Gibraltar, the profits from these activities accrue in or are derived from Gibraltar (provided they are not generated by a branch or permanent establishment outside Gibraltar).

The tax year runs from 1 July to 30 June, and tax is payable on the actual taxable profits for the year.

Given Gibraltar’s very competitive corporate tax rate and the fact that various significant income streams are exempt from tax (e.g., passive investment income) many international operators regard the 10 per cent rate as an entirely reasonable regime. This is complemented by the absence of any capital gains tax or stamp duty (except in the case of Gibraltar real estate).

There is no charge to tax on the receipt by a Gibraltar company of dividends from any other company, regardless of where it is incorporated.

There is no tax on dividends paid by a Gibraltar company to another company and no tax (or withholding) on a dividend to any person not resident in Gibraltar.

Royalties received or receivable by a company in Gibraltar are chargeable to tax (at the usual corporate rate of 10 per cent).

ii  Individual taxation

An individual (not a company or trust) who is a tax resident as defined in the 2010 Act is also liable to pay tax on a worldwide basis in respect of the taxable heads of income.

There are certain incentives, however, designed to attract high net worth individuals and executives possessing particular skills. These make Gibraltar a very attractive base for suitably qualified individuals and their dependants or for retirees or entrepreneurs wishing to live in a tax competitive jurisdiction.

Generally with regard to residence, it should be noted that the 2010 Act provides that an individual is ordinarily resident in Gibraltar if:

\(c\)  he or she is present in Gibraltar during any year of assessment for at least 183 days; and
\(d\)  when considering three consecutive years of assessment, an individual has been present in Gibraltar for more than 300 days over that three-year period.

Any presence in Gibraltar in any 24-hour period commencing at midnight shall be counted as a day, irrespective of whether accommodation in Gibraltar is used or not.

The 2010 Act provides two main systems that individual taxpayers are able to choose between so as to ensure a lower tax payment. These are described respectively as the ‘allowance-based system’ and the ‘gross income-based system’.

** Allowance-based system

This allows an individual taxpayer to claim a large number of allowances and deductions against his or her chargeable income. These allowances include personal, spouses and civil partners allowances (£3,385 each), nursery allowance (£5,290) and blind persons allowances (£5,285), and in respect of one child (£1,165) and for each child studying abroad (£1,325). Medical insurance premium payments (£5,285) and a one-off residential property purchase allowance (£12,000 spread over a number of years, and an additional allowance of £4,000 restricted to a maximum of £1,000 per year) are also allowed. Mortgage interest relief to acquire Gibraltar property to be used as a taxpayer’s principal residence is available on loans up to a value of £350,000.

The tax rates applicable to the allowance-based system are as follows:

<table>
<thead>
<tr>
<th>Taxable income bands</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0–£4,000</td>
<td>14%</td>
</tr>
<tr>
<td>£4,001–£16,000</td>
<td>17%</td>
</tr>
<tr>
<td>£16,001 and above</td>
<td>39%</td>
</tr>
</tbody>
</table>

** Gross income-based system

This system allows for a much smaller number of deductions or allowances but applies reduced rates of tax on gross income as follows:

<table>
<thead>
<tr>
<th>Taxable income bands</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0–£17,000</td>
<td>16%</td>
</tr>
<tr>
<td>£17,001–£25,000</td>
<td>19%</td>
</tr>
<tr>
<td>£25,001–£40,000</td>
<td>25%</td>
</tr>
<tr>
<td>£40,001–£105,000</td>
<td>28%</td>
</tr>
<tr>
<td>£105,001–£500,000</td>
<td>25%</td>
</tr>
<tr>
<td>£500,001–£700,000</td>
<td>18%</td>
</tr>
<tr>
<td>£700,001 and above</td>
<td>5%</td>
</tr>
</tbody>
</table>

The gross income-based system is generally regarded as the most simple and beneficial for taxpayers. It is usually the case that this assessment will deliver the lowest level of income tax.

### iii  Property rental scheme

This measure was introduced in the 2016 Budget. This provides that the owner of any property constructed in the 30 months following 1 July 2016, that is then rented for residential purposes, will receive a tax credit equal to the tax payable on the profits earned on the first 24 months’ rent occurring in the first five years after the completion of the construction of that property. The tax credit will not be refundable and may be set off against tax payable to extinguish any liability to tax.
iv Developments related to personal taxation for individuals generally and in relation to gift and succession taxes

One current feature of the tax system worthy of note is the regressive rates (under the gross income based system) in respect of higher incomes. Recent budget measures further enhanced this aspect providing that taxable income over £700,000 is subject to tax at 5 per cent (see table above). These measures are, of course, quite separate to the Category 2 or Higher Executives Possessing Specialist Skills (HEPSS) schemes (described below) and are applicable to all taxpayers.

Gibraltar does not levy any gift, succession or inheritance taxes. It does not have any capital gains or wealth taxes. There is also no stamp duty in respect of share transfers, other than on Gibraltar real estate transactions and nominal (£10) capital duty on incorporation of a company.

There is no tax on passive investment income (including bank interest or dividends from quoted securities or funds invested in these).

Gibraltar does charge tax on intergroup corporate interest (subject, however, to a *de minimis* threshold of £100,000 per year interest) in respect of any such group lending.

As noted previously, there is no VAT.

v Issues relating to cross-border structuring

The two main issues impacting on the nature of private client and corporate cross-border structuring are the inexorable drive towards (perhaps complete) transparency and the international agendas designed to eliminate taxation arbitrage which is regarded as overly aggressive.

We are also witnessing heightened levels of vigilance and scrutiny from certain European domestic tax authorities (e.g., Spain and Portugal), which are driving clients to reconsider their residence, family office and private holding structures. Gibraltar has been the beneficiary of some of these developments by providing a safe and convenient alternative. As described below in Section II.vi these developments have increased the interest and use of Gibraltar as a residential base and wealth planning platform. It is not uncommon for new Gibraltar residents who rent or have bought property in Gibraltar to spend some time in Spain or Portugal (a perfectly workable arrangement provided they are careful not to spend more than 183 days a year in Spain or Portugal and they do not have their centre of economic and family interests based in those jurisdictions). The Brexit vote has also increased the number of queries from British expatriates settled in the Iberian Peninsular. Gibraltar is regarded as a potential and close-at-hand alternative if the outcome of Brexit negotiations makes it more difficult to reside in either Spain or Portugal.

More broadly, Gibraltar’s EU passporting rights allowing for cross-border services has redefined the banking sector locally and remains very relevant across the financial services and e-commerce industries. The future shape and scope of the private banking sector locally continues to be a critical issue in common with the concerns in other banking centres and following the Brexit vote. Increased regulatory, compliance and governance costs challenge the business models of some existing operations. These pressures are unlikely to wane and may, therefore, bring about further realignment or consolidation.

Gibraltar has adopted the EU Savings Directive, the Mutual Assistance Directive and the Mutual Legal Assistance Convention. It has also entered into an extensive network of tax information exchange agreements. There are now 27 bilateral tax information exchange agreements with various countries, including the United States, the United Kingdom, France,
Germany and most other European territories. The effect of Gibraltar’s adoption of various international conventions and directives is that exchange arrangements extend to a very large number of countries, including Spain.

Gibraltar has transposed the EU Directive 2014/107/EU on automatic exchange of information with all Member States of the EU via the introduction of regulations. These Regulations implement the EU Common Reporting Standard (CRS) into Gibraltar law.

On 26 June 2017, the Register of Ultimate Beneficial Owners Regulations came into operation. These Regulations create a central register of beneficial owners. By doing so, Gibraltar aims to improve tax transparency within the jurisdiction.

Gibraltar is an excellent location for the headquartering of corporate activities. The combination of robust regulatory and governance regimes and competitive taxation work well to deliver a strong environment. The majority of the work being attracted to Gibraltar currently involves the establishment of a bricks and mortar presence. The fact that Gibraltar is not an island (but is physically connected to southern Spain) assists significantly in giving this process real traction. It effectively permits Gibraltar to act as an economic engine for the area (putting to use the surrounding area as a residential and facilities base). This commercial relationship has an almost unlimited potential for further growth for the benefit of both Gibraltar and the surrounding region.

The Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting agenda and the related EU initiatives will continue to push cross-border corporate structures towards greater transparency and substance. The focus on ensuring no ‘double non-taxation’ and on the challenges posed by the digital economy are particularly significant. Gibraltar’s approach is to view these developments as an opportunity for a greater physical presence and more demonstrable control, management and regulatory accountability. This will affect various aspects of international families’ businesses and administration arrangements. In particular, the location, function and operation of family offices will require renewed consideration.

vi Regulatory issues and special arrangements relating to high net worth individuals or specialist skills

High net worth Category 2 individuals

The Qualifying (Category 2) Individuals Rules 2004 provide for a well-established regime that limits income tax for high net worth individuals wishing to reside in Gibraltar.

The Category 2 programme has enjoyed great success since it was first introduced in the early 1990s. In order to apply for a certificate, an individual is required to verify that he or she has a minimum net worth of £2 million (usually in bank deposits or securities) and is of good character. The holder of a Category 2 certificate is taxed in Gibraltar on the basis of the normal rates applicable under the gross income-based system but only on the first £80,000 of assessable income. There is, however, a minimum annual tax payment of £22,000. Any income in excess of £80,000 is not subject to income tax in Gibraltar (irrespective of whether the income is remitted locally or otherwise). This effectively gives rise to a maximum tax liability in the order of £27,560, irrespective of worldwide income (at current 2017/18 rates).

3 See Gibraltar Chamber of Commerce commissioned report entitled ‘An Economic Impact Study and Analysis of the Economies of Gibraltar and the Campo de Gibraltar – update 2015’. Among its findings the report highlights that the number of jobs supported by the Gibraltar economy (i.e., within Gibraltar) is equivalent to one-quarter of the total jobs in the Campo surrounding area.
The benefits of a Category 2 certificate (which is a lifetime status subject to the eligibility criteria being satisfied on an ongoing basis) can extend to the worldwide income of a spouse or civil partner and of dependent children (up to 18 years or end of higher education).

A Category 2 individual is required to either rent or buy appropriate accommodation in Gibraltar for his or her exclusive use.

It should be noted that the general principle is that Category 2 individuals should not seek mainstream employment in Gibraltar or carry out business in competition with ordinary taxpayers. This principle holds whether the individual is carrying out business personally or via a legal entity such as a company.

Thus, it follows that a Category 2 individual should not derive ‘earned’ income from activities in Gibraltar unless it can be proved, to the satisfaction of the Ministry of Finance, that there is exceptional economic benefit for Gibraltar, which, in the opinion of the Ministry of Finance, warrants a departure from the general principle. In practice, this latitude has developed to encompass what is currently a wide spectrum of activities.

There are, therefore, various examples of economic activity that a Category 2 individual can undertake in Gibraltar. These are in accordance with published guidelines and include the following:

a. owning a Gibraltar company for investment purposes in, for example, bank deposits, equities and bonds;
b. owning a Gibraltar company to invest and trade in properties throughout the world;
c. owning a Gibraltar company for trading in goods outside Gibraltar;
d. doing any of the above from a physical office set up in Gibraltar;
e. receiving director’s remuneration as well as dividends in respect of any of the above;
f. being only a shareholder in a company carrying out activities licensable in Gibraltar under applicable financial services or gambling legislation;
g. being only a shareholder in a company carrying out a business in Gibraltar that is not in competition with other businesses in Gibraltar;
h. investing, either personally or through a company or another entity, directly or indirectly, in the purchase of property situated in Gibraltar for investment purposes. However, the rental income arising from any such properties is taxable in Gibraltar either on the company or the individual and therefore does not form part of the individual’s tax shelter deriving from his or her Category 2 status;
i. providing consultancy services to non-Gibraltar companies or receiving employment income from companies outside Gibraltar, as long as those services or employment are physically carried out exclusively outside of Gibraltar; and
j. from within Gibraltar, providing consultancy services to companies or other entities trading outside Gibraltar if that individual owns and controls or is connected by a significant shareholding or ownership interest in such company or entity. ‘Consultancy’ in this paragraph means consultancy to a company or entity itself and not the provision of advice or services to a client of that company or entity.

The profile of Category 2 residents has changed considerably over the last 25 years. Category 2 certificate holders now tend to become longer term residents contributing to, and engaging socially, economically and often philanthropically, with Gibraltar. This has meant real estate of increasing quality has become more readily available locally, with a marked
improvement in the entertainment, restaurant and cultural scene. The policy direction is to encourage further residence by such entrepreneurs and high net worth individuals and to underpin this drive with increased investment in Gibraltar’s infrastructure.

_Entrepreneurs and individuals with specialist skills_

Gibraltar is keen to continue to attract individuals who bring special skills not available locally. The HEPSS Rules 2008 provide a favourable tax regime for individuals who possess particular skills in key positions in a business established locally.

The basic requirements in respect of such applicants are the following:

- basic salary of over £120,000 per year;
- the skills must not be available in Gibraltar;
- exclusive accommodation must be arranged in Gibraltar (either rented or purchased); and
- he or she cannot have been resident in Gibraltar within the past 36 months.

A person in possession of a HEPSS certificate is only taxed (on the basis of the gross income-based system) on the first £120,000 of assessable income (including any bonuses, prerequisites and other benefits in kind connected with employment). As at 2018, this would result in a maximum tax payment of around £30,000 per annum.

There are also various additional allowances (e.g., relocation provisions) to facilitate the attraction of specialist skills.

This HEPSS programme has played an important role diversifying and widening the skills base of the Gibraltar economy. HEPSS status has been particularly relevant in the remote gambling and financial services sectors. The creation of a critical mass of specialists in particular areas (e.g., e-commerce and IT) has generated the growth of peripheral activities (ranging from services to family offices to payment-processing operations).

### III SUCCESSION

#### i Introduction

As is the position in the United Kingdom, the basic principle of succession law in Gibraltar is freedom of testamentary disposition. There are no forced heirship rules applicable and we have not adopted the EU succession and wills regulation.

There are, however, rights for spouses and civil partners and certain dependants to make certain claims on the estate of an individual under the Inheritance (Provision for Family and Dependants) Act 1977 (largely based on the UK 1975 Act).

Probate and administration of estates in Gibraltar is generally similar in procedure to that of England and Wales. Because of the nature of Gibraltar’s international client base, the jurisdiction is very familiar with cross-border succession and probate matters. Practitioners regularly deal with international succession and planning.

#### ii Key legislative or case law changes affecting succession

A significant development in succession and matrimonial arrangements relates to prenuptial agreements. Gibraltar has adopted legislation to allow for the recognition and enforceability of prenuptial arrangements in various circumstances. Amendments to the Matrimonial Causes
Act provide a framework for the entry into and enforcement of financial arrangements. The legislation allows for prenuptial agreements to regulate matters between spouses in respect of the following:

a how, in the event of a breakdown of a marriage, all or any of the property or financial resources of either or both of the spouses at the time when the agreement is made, or at a later date and before divorce is to be dealt with; and

b the maintenance of either of the spouses:
   • during the marriage;
   • after divorce; or
   • both during marriage and after divorce.

The position in respect of children and dependants is more qualified. Provision in a financial agreement relating to the maintenance of children is void unless approved by the court. Furthermore, there is a general provision that allows the court to revisit the terms of a prenuptial agreement if it is satisfied that, when the agreement came into effect, the circumstances of the party were such that, taking into account the terms and effect of the agreement, the party was unable to support himself or herself without an income or pension, allowance or benefit.

It is critical, therefore, that the parties are fully and independently advised to ensure the best prospects of validity. The need for independent legal advice for each spouse is a statutory requirement of enforceability.

It should be noted that a prenuptial financial agreement continues to be binding despite the death of one of the parties and operates in favour of and, is binding on, the legal representative of that party.

Another significant development has been the enactment of the Gibraltar Civil Partnership Act 2014 whereby Gibraltar introduced civil partnerships between same-sex couples. Such partnerships enjoy largely the same legal rights and responsibilities as married couples. This includes the entry into financial agreements (largely as applicable to marriages under the Matrimonial Causes Act) in respect of partners. Following the Civil Marriage Amendment Bill being passed in the Gibraltar parliament with unanimous support, same-sex marriage became legal in Gibraltar on 15 December 2015.

In Gibraltar the court has broad power and discretion to make financial orders in a case of a dissolution of either a marriage or civil partnership.

Recent legislative changes now also empower the court to allow for the sharing of a pension between spouses (including a state pension) upon divorce.

iii Relevant cross-border developments

Gibraltar has introduced a number of statutes that impact on arrangements relating to international families. Gibraltar has recently enacted:

a the Trusts (Private International Law) Act 2015;

b the Private Trust Companies Act 2015;

c the Purpose Trusts Act 2015; and

d amendments to the Perpetuities and Accumulations Act.
The Trusts (Private International Law) Act 2015 provides a statutory framework for the disapplication of forced heirship rules and various other claims in defined circumstances connected to trusts. It should be noted that the legislation applies subject to the following:

a  the Hague Trust Convention;
b  any EU regulation, EU directive or international convention by which Gibraltar is bound, or may become bound, which in relation to particular matters, contains rules as to jurisdiction or the recognition or enforcement of judgments; and

c  Section 419A of the Insolvency Act 2011 (relating to asset protection trusts).

For the purposes of the Trusts (Private International Law) Act 2015, Gibraltar is regarded as a separate Member State in relation to the Member States of the EU or the EEA signatories to any of them.

Under Section 419A of the Insolvency Act 2011, provision is made for an increased degree of protection of assets transferred into trusts in certain defined circumstances. Assuming the appropriate conditions are met (in particular a settlor must not become insolvent as a result of a transfer), a disposition to a trust will not be voidable at the instance of, or upon application of, any creditor of the settlor. The trust requires registration and the transfer to the settlement must be supported by an affidavit of solvency provided by the settlor. Gibraltar’s asset protection trust legislation is generally regarded as being less aggressive than that of other jurisdictions but has nonetheless proved popular in structuring arrangements designed to deliver a higher level of creditor protection.

The Private Trusts Companies Act 2015 codifies and makes extended provisions for the use of private trust companies which have been common in Gibraltar. The Act provides for a voluntary form of registration of private companies (thus allowing, if thought desirable, the continued use of private companies on an unregistered basis).

The Act allows a private trust company to be used in respect of individuals connected to the settlor. These extend to:
a  his or her spouse or civil partner; and
b  the children and remoter issue of the settlor and his or her spouse or partner.

The Purpose Trusts Act 2015 introduces a regime for purpose trusts other than for charitable purposes.

The legislation follows the enactments in a number of other jurisdictions, providing for an enforcer and broad powers to make applications to the court by the enforcer, trustees, unless the trust document provides otherwise the settlor, or any person who upon application is declared by the court to have an interest in advancing the trusts purposes.

The Attorney General may also in certain limited default circumstances intervene and make an application to the court.

Amendments to the Perpetuities and Accumulations Act have extended the statutory perpetuity period to 250 years.
IV  WEALTH STRUCTURING AND REGULATION

i  Commonly used vehicles for wealth structuring, such as trusts, foundations or partnerships

As a common law jurisdiction, Gibraltar trusts are extensively used in succession and estate planning. These come in a variety of forms and are largely drafted along the lines of English settlements. Companies and partnership arrangements are also widely used.

Although there is no mandatory requirement (indeed, as in other jurisdictions, the vast majority of trust arrangements remain confidential), Gibraltar law allows for the voluntary registration of trusts. The Registered Trusts Act 1999 provides for the registration of a certain minimum amount of information relating to a trust (name, identity of trustees and date of creation). Such a registration facility is often regarded as helpful to formally record, when appropriate, the creation of a trust (especially relevant for clients with a civil law background).

The Gibraltar Private Foundation Act 2017 introduced a new vehicle to Gibraltar’s offering. Foundations, which are commonly used in civil law jurisdictions, are now able to be established in Gibraltar. A foundation is an entity with separate legal personality that is able to hold and deal with property in its own name as absolute legal and beneficial owner, for the specific purposes that are detailed in the Foundation Charter. The purposes can be very broad, need not be charitable, and indeed can be ‘anything capable of fulfilment’ as long as they are not illegal, immoral or contrary to public policy. As long as the Foundation Charter permits, the purposes of the foundation can be amended, providing flexibility in the event of future changes of circumstances.

ii  Legal and tax treatment of commonly used vehicles

Gibraltar law does not tax trusts settled by non-residents for exclusively non-resident beneficiaries except in the case of Gibraltar taxable source income. As previously noted, passive investment income (to include bank interest or dividends from quoted securities or funds invested in these) are not taxable in Gibraltar in any event.

A Category 2 individual, while being a resident in Gibraltar, is nonetheless regarded as non-resident for the purposes of the establishment of a Gibraltar trust.

Gibraltar resident beneficiaries pay tax upon a distribution of income to them. No income, however, will be deemed to be distributed to them until this occurs.

As noted earlier, Gibraltar companies are liable to pay tax at 10 per cent on the profits of income that accrues in or derives from Gibraltar. There is a limited exception in relation to utility companies that pay at a higher rate of 20 per cent (though telecommunications companies pay the lower 10 per cent tax on non-telecommunications income, such as data centres).

Partnerships (both general and limited) are regarded as see-through for tax purposes. It is, therefore, the constituent partners (individual or corporate) that are assessed for tax.

iii  Applicable anti-money laundering regime and other key aspects of regulation of service providers dealing with private wealth

Gibraltar has adopted very strong anti-money laundering legislation, systems and administrative practices. The Proceeds of Crime Act 2015 brings together in a consolidated enactment previous obligations contained in a number of statutes. Gibraltar’s system derives from all applicable European Union legislation and is based largely on the standards and procedures in the United Kingdom.

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Gibraltar’s legislation, systems and administrative practices have been independently tested and reviewed by the Financial Action Task Force, the IMF and others. They have found Gibraltar’s systems to be robust, effective and in accordance with best international standards.

Providers to the general public involved in company management and fiduciary services are required to be licensed and subject to regulation by the Financial Services Commission. Family office and private family holding management arrangements that do not provide services to third parties for profit do not come within the ambit of licensable activities.

V OUTLOOK AND CONCLUSIONS

Gibraltar’s response to international developments relating to transparency, anti-money laundering requirements and aggressive tax planning has been to increasingly focus on substance.

The outcome of the Brexit vote will clearly require adjustments, both in the UK and Gibraltar, over the next few years. Indeed, there will be opportunities for Gibraltar (and the UK) to leverage the benefits of the less prescriptive regime that is currently being negotiated.

Naturally, OECD and EU tax-related agendas (e.g., base erosion and profit shifting) represent a major threat to some aspects of planning that advisers have historically promoted. They undoubtedly, however, also represent an opportunity for those jurisdictions committed to and operating to best international standards, first-tier regulation and with competitive tax and residence regimes.
Greece remains a jurisdiction where medium and large businesses are owned and managed by Greek families who need advice on the structuring of the generational transfer of business. Furthermore, Greece attracts foreigners that relocate to Greece and require pre-immigration advice on the operation of the Greek forced heirship rules and the tax efficiency of existing ownership structures.

In addition, Greece attracts investments in real estate, by non-resident private clients, who need advice on the structuring of the acquisition, ownership and disposal of such investments. Furthermore, owing to the beneficial tax regime of shipping companies operating under Law No. 27/1975, Greece attracts relevant activities. Lately, amendments have been introduced into the Greek tax legislation dealing with individuals’ wealth, such as provisions relating to controlled foreign companies (CFC) rules.

The new Income Tax Code (Law No. 4172/2013 (ITC)), effective from 1 January 2014, as recently amended, introduces a number of significant changes to the tax rules, including measures designated to combat tax avoidance and tax evasion. For instance, under the new ITC, any wealth increase deriving from an illegal, unjustified or unknown source or cause is considered as business profits subject to tax at 33 per cent.

In addition, the new Tax Procedures Code (Law No. 4174/2013 (TPC)), as recently amended, which is a separate piece of legislation, explicitly introduces a ‘general anti-avoidance provision’, as a measure to combat tax avoidance and tax evasion. In this frame, under Article 66 of the TPC, the meaning of acts of tax avoidance is broadened and the meaning of concealment of income is clarified.

Finally, in terms of ruling, from a tax perspective, wealth, income and succession planning, Greece may use an extensive double taxation treaty network (57 income tax treaties and five estate tax treaties).

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1 Aspasia Malliou is a partner and Maria Kilatou is an associate of the tax law department at PotamitisVekris. This article was originally written by Aspasia Malliou and Eleni Siabi (a former associate of PotamitisVekris). In addition, it has been reviewed by Alexios Papastavrou, Kelly Papadaki and Anastasia Platipodi. Alexios Papastavrou is a partner and Kelly Papadaki and Anastasia Platipodi are associates of the family and inheritance law department at PotamitisVekris.
II TAX

i Greek tax residence

Individuals who are tax residents of Greece are subject to Greek income tax on their worldwide income (Greek and foreign income) while a foreign tax credit is provided on foreign income declared in accordance with the Organisation for Economic Co-operation and Development (OECD) guidelines for the avoidance of double taxation. Non-Greek tax residents are subject to Greek income tax only for their income sourced in Greece. The Greek ITC provides an indicative list of income considered as arising in Greece (Greek-sourced income).

For income tax purposes, an individual is considered as a Greek tax resident, provided that he or she maintains in Greece his or her permanent or primary residence or habitual abode or the centre of his or her vital interests (i.e., personal, economic and social bonds) or he or she is a consular or diplomatic employee or public officer of similar status or a civil servant of Greek nationality and serving abroad.

Also, an individual residing in Greece continuously for a period of more than 183 days is considered as a Greek tax resident. This is not applicable in cases of an individual residing in Greece exclusively for tourism, medical, therapeutic or similar private purposes, if his or her residence does not exceed a period of 365 days, including short-term stays abroad. The above provision may not be applicable if a double taxation treaty (DTT) (ratified by law) exists, in which case DTT provides a different way of taxation from the tax residence of the other country – party of the DTT. It is mentioned that DTT, by its integration into Greek (domestic) law, has automatically acquired an increased legislative power over the domestic legislation, according to Article 28 of the Greek Constitution.

Greece has entered into DTTs with the following countries, providing beneficial income tax provisions compared to internal income tax legislation: Albania, Armenia, Austria, Azerbaijan, Belgium, Bosnia-Herzegovina, Bulgaria, Canada, China, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Estonia, Finland, France, Georgia, Germany, Hungary, Iceland, India, Ireland, Israel, Italy, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Malta, Mexico, Moldova, Morocco, Netherlands, Norway, Poland, Portugal, Qatar, Romania, Russia, San Marino, Saudi Arabia, Serbia, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, Ukraine, United Arab Emirates, United Kingdom, United States and Uzbekistan.

ii Income tax

The following four categories of income are subject to income tax under the current ITC:

a income derived from employment and pension;
b income derived from business activities;
c capital income; and
d capital gains income.

Different tax rates apply to the above categories for individuals. The applicable tax rates are either progressive or tax exhaustive (one-off tax). The above-mentioned types of income are taxed as follows.

Income derived from employment or pensions

Income derived from employment or pensions is considered to be the gross income from salaried work and pensions, and includes all types of income, in cash or kind acquired, in
the context of any current, past or future employment relationship. In addition, the ITC explicitly provides that the board of directors’ fees are categorised as employment income for tax purposes.

Apart from the general provision for the taxation of salaries, the ITC contains provisions for the taxation of specific benefits in kind annually exceeding €300 that are considered as taxable income derived from employment for the employee and are added to the gross income from salaried work and pensions. Benefits in kind indicatively include the following:

- **a** the value of goods represented by gift cheques;
- **b** the value of vouchers given free of charge to purchase goods or services at associated stores. In the case of food vouchers, the benefit in kind is assumed to be any amount exceeding €6 per working day;
- **c** use of company credit cards to cover expenses not incurred on behalf of the company, but to cover personal, family or other expenses unrelated to the business interests of the employer or not used in normal commercial transactions, where the cost is assumed by the employer;
- **d** the benefit accruing to employees, managers, administrators, board members and pensions or companies providing energy, telephony, water supplies, gas, subscriber services (such as television) from providing them with a certain quantity of electricity, phone calls, water, natural gas and subscriber channels, at either a reduced rate or free of charge;
- **e** various payments made directly by employers to third parties such as payments to extra tuition centres, schools, nurseries, campsites, etc., to cover tuition costs, nursery fees, etc., direct payments to cover the cost of such persons participating in workshops, programmes or training, education training courses, or to cover subscriptions to journals or chambers, unrelated to their business activities or the post they hold; and
- **f** the provision of company mobile phone connections to employees, managers and board members to the extent that it goes beyond the cost of their tariff plan, provided that the excess above the tariff plan is used for personal reasons and not for reasons associated with the employer’s business activities.

From 1 January 2016, income from employment or pensions is taxed according to the following progressive tax scale:

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €20,000</td>
<td>22%</td>
</tr>
<tr>
<td>€20,001 to €30,000</td>
<td>29%</td>
</tr>
<tr>
<td>€30,001 to €40,000</td>
<td>37%</td>
</tr>
<tr>
<td>€40,001 and above</td>
<td>45%</td>
</tr>
</tbody>
</table>

From 1 January 2020 onwards, income from employment or pensions will be taxed according to the following progressive tax scale:

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €20,000</td>
<td>20%</td>
</tr>
<tr>
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<td>29%</td>
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<tr>
<td>€30,001 to €40,000</td>
<td>37%</td>
</tr>
<tr>
<td>€40,001 and above</td>
<td>45%</td>
</tr>
</tbody>
</table>
Income derived from business activities

Individuals are subject to income tax on business income, which is defined as the total revenue from business transactions as well as from independent professions after the deduction of any business expenses, deprecations and bad debts. The business income is taxed according to the following tax scale:

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
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<td>Up to €20,000</td>
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<td>37%</td>
</tr>
<tr>
<td>€40,001 and above</td>
<td>45%</td>
</tr>
</tbody>
</table>

Moreover, according to the ITC, any increase of wealth for an individual deriving from an illegal, unjustified or unknown source or cause is considered as income derived from business activities and is further subject to tax at 33 per cent.

Capital income

Capital income is a distinct category of income and includes the income, in cash or in kind, from dividends, interests, royalties and immovable property.

Income from dividends is defined as the income from shares, founders’ shares, or other rights of participation in profits that are not debts, as well as income from other corporate rights, including interim dividends and actuarial reserves, profits from partnerships and any other distributed amount.

Income from interest is defined as the income on any kind of claims, either secured by mortgage or not, whether providing a right to participate in profits of the debtor or not. Specifically, this includes income from deposits, government securities, bonds (with or without security) and from every kind of loan agreement, including premiums, repurchase agreements or reverse repurchase agreements and rewards derived from shares, partnerships, bonds or securities. There is a tax exemption regarding the income by the interest of bond loans and treasury bills of the Greek state, received by individuals, as well as to the interest arising from bonds issued by the European Financial Stability Facility in application of the programme for the restructuring of the Greek debt.

Income from royalties is defined as the income gained in exchange for the use or the right to use any kind of intellectual property rights.

Income from real estate property is defined as the income (in cash or in kind) derived from leasing (rental), self-use or the free concession of the use of land or real estate property. The income received in kind is calculated at the market value. In addition, the income for self-use or the free concession of use is equal to 3 per cent of the objective value of the property. A tax exemption is applied to the aforementioned presumptive income in the case of the free concession of the use of the real estate property – which shall not exceed 200 square metres – to a relative in the ascending or the descending line, who will use it as his or her main residence.

The capital income earned by an individual is subject to withholding tax as follows:

- Dividends distribution is subject to a withholding tax at the rate of 10 per cent, with effect for payments performed up to the tax year 2016 and 15 per cent for the tax year 2017 onwards, exhausting any further tax liability for individuals (final tax);
Interest payments are subject to a withholding tax rate of 15 per cent, exhausting any further tax liability for individuals (final tax); and royalties payments are subject to a withholding tax at the rate of 20 per cent, exhausting any further tax liability for individuals (final tax).

Income from immovable property sourced by the leasing (rental) or by the self-using (presumptive income) of the real estate property is subject to income tax in accordance with the following tax scale, which is applicable to income gained as of 1 January 2017, onwards:

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €12,000</td>
<td>15 per cent</td>
</tr>
<tr>
<td>€12,001 to €35,000</td>
<td>35 per cent</td>
</tr>
<tr>
<td>€35,001 and above</td>
<td>45 per cent</td>
</tr>
</tbody>
</table>

**Short-term lease: Airbnb**

As of 1 January 2017, income from the short-term lease of real estate in the context of the sharing economy is taxed in accordance with the provisions of Article 39A of the ITC.

Specifically, rental income from the short-term lease of immovable property in the sharing economy is considered as taxable income deriving from immovable property, provided the immovable property is furnished when rented, without the provision of any additional service other than the provision of bed linen, and is taxed pursuant to the corresponding applicable tax scale (15 per cent to 45 per cent). If any additional services are provided, the income is considered as business income and taxed according to the corresponding applicable tax scale (22 per cent to 45 per cent).

Short-term lease of immovable property in the context of the sharing economy (Article 39A of the ITC) is exempt from value added tax (VAT), provided that, during the lease, the lessor does not provide additional services to guests similar to those offered in hotels, such as cleaning services, waste collection, changing linen and other customer care services. The supply of bed linen is not considered an additional service and therefore has no effect on the VAT exemption. Also, other utilities such as electricity, water and internet connection, which are charged to the host and subsequently passed on to the guest, are included in the value of the rental price and therefore are not considered additional services and do not affect the VAT exemption.

**Capital gains income**

Any surplus that arises from the transfer of capital (i.e., real estate property, securities, listed shares, sovereign bonds, interest-bearing bills, company bills or derivative financial products as described in the ITC) is considered income from capital gains and is subject to tax at a rate of 15 per cent. The taxable surplus is the difference between the purchase (acquisition) price and the transfer (selling) price. An exemption from the said tax is applied in special cases. For example, any capital gains derived from the transfer of securities by individuals could be exempted from capital gains tax if said individuals are tax residents of another state with which a DTT has been signed, and provided that all the necessary documentation is submitted to the relevant tax administration authority, evidencing the residence of the aforementioned individuals to these states.

Taxation on capital gains from the transfer of real estate property is postponed until 31 December 2018.
iii Special income tax provisions provided by the ITC

Alternative method for determining minimum taxation (deemed income)

The ITC provides an alternative method for calculating the minimum tax obligation of individuals according to certain objective criteria. If, after application of those objective criteria, the deemed income of the taxpayer is higher than the declared income, he or she will be taxed according to his or her deemed income.

Deemed income may derive either from 'living expenses' from assets owned or from 'actual expenses' from the amount spent to purchase assets and is calculated after taking into account the following objective criteria:

\begin{itemize}
\item[a] the surface area of the main residence of the taxpayer in combination with its tax value;
\item[b] the surface area of any secondary residences of the taxpayer;
\item[c] the size of the engines (e.g., 1,200cc, 1,400cc) of any cars of the taxpayer, in combination with the year of the car's production;
\item[d] salaries of housemaids and other staff;
\item[e] fees for private schools for the taxpayer's children;
\item[f] leisure boats;
\item[g] aeroplanes; and
\item[h] swimming pools.
\end{itemize}

Purchases of cars, motorcycles, boats, aeroplanes and other goods that cost above €10,000, the establishment or the participation in the capital increase of a company under the form of an unlimited or limited liability partnership or corporation or limited liability company or private corporation or society of civil law or joint venture or purchase of company parts or securities, as well as payments to insurance investment contracts, to the extent that they constitute investment product, are taken into account in the calculation of the taxpayer's annual deemed income. The taxpayer can, under certain conditions, cover the difference between actually declared income and income that is deemed after the application of the above rules, by showing that the amount in excess of the declared income is justified by savings made from income taxed in previous years.

Deemed income provisions are not applicable in the case of a foreign tax resident who does not earn income from Greek sources.

Controlled foreign companies

CFC rules have recently been introduced in the ITC, with the aim of dealing with the tax avoidance of Greek companies or individuals, through shifting revenues to subsidiaries in low-tax jurisdictions.

It is specified that the taxable income of an individual Greek tax resident includes the non-distributed income of legal or other entities tax-resident in another state, provided that the following conditions are cumulatively met:

\begin{itemize}
\item[a] the taxpayer, on his or her own or jointly with related persons, holds, directly or indirectly, shares, parts, participations, voting rights or participations in the capital at a percentage exceeding 50 per cent, or is entitled to receive a percentage exceeding 50 per cent of the profits of the said legal or other entity;
\item[b] the above legal or other entity is subject to taxation in a non-cooperative state or state with a preferential tax regime, namely to a special regime allowing for a substantially lower level of taxation than the general regime;
\end{itemize}
c a percentage exceeding 30 per cent of the net income before taxes realised by the legal entity or other entity falls under one or more of the following categories:
• interest or any other income generated from financial assets;
• royalties or any other income generated from intellectual property;
• income derived from dividends and the transfer of shares;
• income derived from movable assets;
• income derived from real estate property, unless the Member State of the taxpayer, legal entity or other entity would not be entitled to tax such income according to an agreement concluded with a third country; and
• income derived from insurance, bank and other financial activities; and

d it is not a company with a principal category of shares traded in an organised market.

The above shall not apply to cases where the legal person or legal entity is a tax resident of a Member State of the European Union or a tax resident of a country that is a party to the EEA Agreement, unless the legal person or legal entity’s establishment or economic activities are an artificial arrangement devised for the purpose of avoiding the corresponding tax.

This income is taxed at the rates applicable to income derived from business activities, as they are provided above.

iv Solidarity tax contribution on individuals’ income from tax year 2016

As a result of the economic crisis, a special solidarity tax contribution is imposed on individuals’ total income (both declared and deemed income) of any source that exceeds €12,000 on an annual basis. From 1 January 2020 onwards, a special solidarity tax contribution will be imposed on individuals’ total income of any source that exceeds €30,000 on an annual basis.

For income earned from 1 January 2016, a solidarity tax contribution is imposed in accordance with the progressive rates below:

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €12,000</td>
<td>0%</td>
</tr>
<tr>
<td>€12,001 to €20,000</td>
<td>2.2%</td>
</tr>
<tr>
<td>€20,001 to €30,000</td>
<td>5%</td>
</tr>
<tr>
<td>€30,001 to €40,000</td>
<td>6.5%</td>
</tr>
<tr>
<td>€40,001 to €65,000</td>
<td>7.5%</td>
</tr>
<tr>
<td>€65,001 to €220,000</td>
<td>9%</td>
</tr>
<tr>
<td>€220,001 and above</td>
<td>10%</td>
</tr>
</tbody>
</table>

For income earned from 1 January 2020, onwards, a solidarity tax contribution will be imposed in accordance with the progressive rates below:

<table>
<thead>
<tr>
<th>Income</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to €30,000</td>
<td>0%</td>
</tr>
<tr>
<td>€30,001 to €40,000</td>
<td>2%</td>
</tr>
<tr>
<td>€40,001 to €65,000</td>
<td>5%</td>
</tr>
<tr>
<td>€65,001 to €220,000</td>
<td>9%</td>
</tr>
<tr>
<td>€220,001 and above</td>
<td>10%</td>
</tr>
</tbody>
</table>
In addition, as of 27 May 2016, salaries and wages are subject to withholding tax against solidarity tax contributions in accordance with the above rates.

v **Luxury living tax**

As a result of the economic crisis, from the tax year 2014, a luxury living tax applies on individuals’ income, calculated on the amounts of the annual deemed expenditures arising from the ownership or holding of private passenger cars, aeroplanes, helicopters, yachts and swimming pools, as follows:

a) for passenger cars from 1,929cc to 2,500cc, a tax rate of 5 per cent is applied;

b) for passenger cars more than 2,500cc, a tax rate of 13 per cent is applied (private passenger cars with more than 10 years’ use since their first year on the road are exempted from said tax); and

c) for aircrafts, helicopters, swimming pools and yachts more than 5 metres long, a tax rate of 13 per cent is applied.

vi **Real estate tax**

*Real estate transfer tax*

The rate of the real estate transfer tax is 3 per cent calculated on the value of the real estate property. For tax purposes, a system has been established for the objective calculation of the value (i.e., based on a system of minimum values). According to this system, if contracting parties declare a price lower than the objective price, the taxes are based on the objective price (higher price). Lately, the actual sale prices of real estate in Greece have been significantly reduced and have been much lower than the objective values. As a result, the tax paid on the objective values provided by Greek law is higher than the tax that would be calculated on the actual sale price according to the contract.

*Annual real estate tax*

Annual real estate tax (ENFIA) is imposed on real estate property rights including main and supplementary tax (for real estate over €250,000) and applies to real estate located in Greece that is owned by individuals and entities. ENFIA is payable on an annual basis. The tax payable depends on a number of factors.

*Special tax real estate*

A special tax applies on the value of real estate situated in Greece and owned by a company that has its registered seat at a non-cooperative state, as provided under Article 65 of ITC, at a tax rate of 15 per cent. However, if the company discloses all of its shareholders or ultimate beneficiaries (individuals) who hold a tax identification number in Greece, it is exempt from the special tax. Many other exemptions are also provided.

III **SUCCESSION**

i **Applicable law**

According to international private law, Regulation No. 650/2012 of the European Parliament and of the Council of 4 July 2012 ‘on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession’, with
effect from 17 August 2015, shall apply. The Regulation applies to all civil aspects of the succession to the estates of deceased people. It does not apply to revenue (for example, tax matters), customs or administrative matters. Areas of civil law other than succession, such as matrimonial property regimes, gifts and pension plans are not covered by the regulation.

Regarding the general jurisdiction, the courts of the EU country in which the deceased had his or her habitual residence at the time of death shall have jurisdiction to rule on the succession as a whole. As a rule, the law applicable to succession is the law of the country in which the deceased had his or her habitual residence at the time of death. It can be the law of either an EU or non-EU country. However, before his or her death, a person can instead choose that the applicable law should be the law of his or her country of nationality. For example, a person of multiple nationalities (including Greek) may choose that the applicable law shall be the Greek law. A declaration of this shall be made in the form of a disposition of property upon death (i.e., a will).

The applicable law will govern, for example, the determination of the beneficiaries and their respective shares, the capacity to inherit, the powers of the heirs, the executors of the wills and the administrators of the estate, the liability for the debts under the succession and the sharing out of the estate.

The application of a single law by a single authority to an international succession avoids parallel proceedings, with possibly conflicting judicial decisions. It also ensures that decisions given in an EU country are recognised throughout the EU without need for any special procedure. Decisions enforceable in the EU country where they have been given are enforceable in another EU country when, on the application of an interested party, they have been declared enforceable there by the local court.

The aforementioned regulation also introduces a European Certificate of Succession (ECS) to be used by heirs, legatees having direct rights in the succession and executors of wills or administrators of the estate to invoke their status or exercise their rights or powers in another EU country. Once issued, the ECS will be recognised in all EU countries without any special procedure being required. In contrast with national certificates of succession, which have different effects depending on the EU country of issue, the ECS will have the same effects, set out in the Regulation, in all EU countries.

Forced heirship rules
Greek succession law provides for forced heirship rules. The rules on forced heirship protect the closest relatives of the decedent, who may not disinherit them. Forced heirs are always entitled to a certain percentage of the estate (legitimate portion of the estate).

Forced heirs are the descendants of the deceased (children), the surviving spouse and the parents of the deceased. According to Greek inheritance law, forced heirs are entitled to half of the portion they are entitled to in the case of intestacy.

Under forced heirship rules, any disposal by will of the decedent’s estate to the prejudice of the forced heirs is void. Moreover, if the testator donates his or her estate and as a consequence the estate at death is not sufficient to cover the legitimate portions of estate for the forced heirs, then said donation may be cancelled.

ii Taxation of inheritance and gifts inter vivos
According to Article 1 of Law No. 2961/2001 (the Code on taxation of inheritance, gifts *inter vivos* and lottery gains), tax is imposed to any asset acquired by inheritance, gift *inter vivos* and winnings in lotteries, whether acquired by an individual or a corporate entity.
**Inheritance tax**

The legislator provides for a list of assets that are subject to inheritance tax. These are property of any kind situated in Greece that belongs to Greek citizens or foreigners, and movable property situated abroad that belongs to a Greek resident or (under conditions) to a foreigner residing in Greece. Movable property that is located abroad and belongs to a Greek citizen who was established outside Greece for at least 10 consecutive years is exempt from Greek inheritance tax.

**Gift tax**

The legislator provides for a list of assets that are subject to gift tax. These are:

- any movable or immovable property situated in Greece;
- any movable property of a Greek citizen situated abroad; and
- any movable property of a foreign national situated abroad that is being gifted or donated to a Greek or foreign citizen who resides in Greece.

The categories of rates of inheritance and gift tax depend on the relationship of the taxpayers to the decedent or donor. Taxpayers are classed into three categories depending on their proximity to the deceased. Category A includes:

- the spouse;
- the partner who has a contract for co-habitation according to the provisions of Law No. 3719/2008, provided that the partnership was in existence at the time of death and it lasted at least two years;
- children;
- grandchildren; and
- parents.

Category B includes:

- great-grandchildren et seq.;
- grandparents and great-grandparents;
- voluntarily or judicially recognised children as against the parents of the father who recognised them;
- the children of a recognised child as against the father who recognised them and his parents;
- brothers and sisters;
- collateral relatives of the third degree;
- stepfathers and stepmothers;
- children of the spouse from a previous marriage; and

Category C includes the remaining relatives and aliens.

The following table illustrates the inheritance tax rates, also applicable on gifts, for the three categories of individuals:
As an exception, by virtue of Law No. 3842/2010, monetary gifts *inter vivos* are taxed at a rate of 10 per cent when the gift is given to a relative of category A, 20 per cent for category B and 40 per cent for category C.

**Tax treaties for the avoidance of double inheritance taxation**

Individuals who are subject to Greek inheritance tax on their worldwide assets can benefit from the Greece inheritance tax treaties. Greece has entered into tax treaties for the avoidance of double taxation in inheritance and estate tax with Germany, Italy, Spain and the United States to prevent double taxation. Thus, individuals who are subject to Greek inheritance tax on their worldwide assets can benefit from the Greek inheritance and estate tax treaties.

### IV WEALTH STRUCTURING AND REGULATION

#### i Trusts and foundations

Trusts and foundations are commonly used vehicles for private wealth structuring and planning. Recently, Circular Pol. No. 1114/2017 was issued by the Independent Authority of Public Revenue, providing for interpretative general guidelines with respect to the tax treatment both of the foreign trusts and foundations and their distributed or undistributed income to Greek tax residents within the framework of Greek income and gift and inheritance taxation. Specifically, pursuant to Circular Pol. No. 1114/2017, the tax treatment depends on the time period within which the taxable events take place as follows.

**Taxable events as of 1 January 2014 onwards**

As of 1 January 2014, the ITC recognises trusts and foundations as taxable legal entities for corporate income tax purposes.

On individuals’ taxation level, any distribution of profits, acquired by the settlor under his or her capacity as beneficiary of the foreign trust or foundation, falls within the definition...
of dividends, being that considered as taxable income, and is subject to Greek income dividend tax of 10 per cent, with effect for payments performed up to the tax year 2016 and 15 per cent, for the tax year 2017 onwards (plus solidarity tax contribution).

In case the settlor or founder and the beneficiary of the trust or foundation is not the same person, the transfer of the trust's assets to the beneficiary is treated as a gift or inheritance for tax purposes and is taxed according to the gift or inheritance tax scale that is applicable based on the relationship between the settlor or founder and the recipient of the assets.

Undistributed income that arises in the trust or foundation could be treated pursuant to the provisions of CFC rules referred to above, provided that all the conditions are cumulatively met.

In the case of the trust or foundation's dissolution and liquidation, the distributed amounts that exceed the initial capital transferred to the trust or foundation are considered as dividends and are subject to Greek income dividend tax of 10 per cent, with effect for payments performed up to the tax year 2016, and 15 per cent, for the tax year 2017 onwards (plus solidarity tax contribution). There is no taxable event to the extent the distributed amounts do not exceed the initial capital since they are considered as capital repayment.

Finally, the transfer of assets into the trust or foundation upon its settlement is not considered a taxable event.

**Taxable events until 31 December 2013**

Greek Law No. 2238/1994, which was applicable on income taxation up to 31 December 2013, recognised only foundations as taxable legal entities for corporate income tax purposes.

On individuals' taxation level, any distribution of profits, acquired by the settlor under his or her capacity as beneficiary of a foreign trust, is subject to income tax at the level of the settlor of the trust depending on the source of income (e.g., interest, dividends, capital gains), while, as per the distribution of profits from a foundation, acquired by the founder under his or her capacity as beneficiary of the foreign foundation, is subject to income tax according to the tax scale applicable on freelancers pursuant to Greek Law No. 2238/1994.

If the settlor or founder and the beneficiary of the trust or foundation is not the same person, the transfer of the trust or foundation's assets to the beneficiaries is treated as a gift or inheritance for tax purposes and is taxed according to the gift or inheritance tax scale that is applicable based on the relationship between the settlor of the trust or foundation and the recipient of the assets.

The trust's dissolution and liquidation is not considered a taxable event, while, in case of the foundation's dissolution and liquidation, the distributed amounts that exceed the initial capital transferred to the foundation are subject to income tax according to the tax scale applicable on freelancers pursuant to Greek Law No. 2238/1994. There is no taxable event to the extent the distributed amounts do not exceed the initial capital since they are considered as capital repayment.

Finally, the transfer of assets into the trust or foundation upon its settlement is not considered a taxable event.

**ii Shipping companies operating under Law No. 27/1975**

Because of the beneficial tax regime of shipping companies operating under Law No. 27/1975, Greece attracts Greek or foreign ship-owning companies with vessels flying a Greek flag and
foreign ship-owning companies with vessels flying a foreign flag, if their management is exercised by Greek companies or foreign companies established in Greece (operating under a special regime of offshore companies), which are subject to tonnage tax.

The Greek tonnage tax regime applies to vessels of categories ‘A’ and ‘B’. Category ‘A’ vessels include cargo vessels, tankers, steel hull vessels for dry or liquid cargo that ply to or between foreign ports, passenger vessels, drilling platforms, etc., while category ‘B’ vessels include small boats and any other motor vessels not listed under category ‘A’. The gross tonnage is calculated by multiplying coefficient rates by each scale of gross registered tonnage. This taxable tonnage is then multiplied by an age-corrected rate. A credit for the tonnage tax paid abroad is provided.

The shipowner is liable to pay the ship’s tonnage tax, whether an individual or a legal entity, who is the registered owner of the relevant ship on the first day of each calendar year. The person managing the ship and collecting the hire as well as the manager’s representative, subject to the latter having accepted the relevant appointment in writing, are also jointly and severally liable to pay the ship’s tonnage tax.

Various exemptions and reductions of the tonnage tax apply, such as vessels built in shipyards in Greece, under a Greek flag, are exempt from tax for the first six years. Also, a 50 per cent reduction for vessels operating regular routes between Greek and foreign ports or solely between foreign ports.

The payment of the tonnage tax exhausts all income tax liability of the shipowner with respect to income derived from the ship’s operation; the exhaustion of tax liability also applies to the shareholders or partners of a (Greek or foreign) shipping company. It also covers all capital gains arising out of the sale of the vessel, realised at the level of either the shipowner, shipping company or their shareholders. If a company that owns a Greek-flagged ship also has commercial activities other than the operation of the ship, exemption from income tax applies to the net profits that correspond pro rata to the gross income the owner derives from ships, subject to the tonnage tax regime.

In addition, the shareholders of the above-mentioned companies are exempt from any tax, duty, contribution or withholding, up to natural person, for the income acquired from dividends or distribution of net profits, whether such profits are acquired directly or through holding companies. Exemption from any taxation of the transfer of shares or parts of Greek or foreign shipowner companies, under Greek or foreign flags, regardless of the reason that the transfer applies. On the contrary, a 10 per cent withholding tax is applicable on dividend distributions, exhausting any further tax liability, to Greek tax residents by offices that are engaged in activities such as chartering, insurance, brokerage, etc, other than the management and exploitation of Greek or foreign-flagged ships.

According to Article 29 of Law No. 27/1975, exemption from inheritance tax applies with respect to transfers of vessels, stocks or shares of Greek or foreign companies that own vessels flying a Greek or foreign flag with gross tonnage of over 1,500 and of stocks or shares of holding companies that hold stocks or shares of shipping companies, whether directly or through holding companies.

Finally, an annual contribution, at a regressive tax scale of 5 to 3 per cent, referring to the years 2012–15, and at a regressive tax scale of 7 to 5 per cent, referring to the years 2016–19, is imposed on offices or branches of foreign enterprises that have been established in Greece by virtue of Article 25 of Law No. 27/1975 and that are engaged in the chartering, insurance, average (damage) settlements, purchase, chartering or shipbuilding brokerage, or chartering of insurance of ships under the Greek or foreign flag whose capacity exceeds...
500 gross registered tons, as well as the representation of shipowner companies or undertakings, whose object is identical to the above-mentioned activities. Greek and foreign companies that have established an office or branch under Law No. 27/1975 and are engaged in the management of vessels flying a Greek or foreign flag, as well as in other activities approved by their licence of operation, are exempt from the above-mentioned annual contribution.

iii Anti-avoidance tax provisions

In Greece, a general anti-avoidance tax rule has been introduced for the first time under Article 38 of the TPC, according to which the tax administration may disregard any artificial arrangement or series of arrangements, performed either by individuals or legal entities, that aim to evade taxation and lead to a tax advantage.

An arrangement is considered artificial if it lacks commercial or economic substance. To determine whether an arrangement is artificial, various characteristics are examined. For the purposes of this provision, the goal of an arrangement is to avoid taxation in the event that, regardless of the subjective intention of the taxpayer, it is contrary to the object spirit and purpose of the tax provisions that would apply in the other cases. In order to determine the tax advantage, the amount of tax due taking into consideration such arrangement is compared to the tax payable by the taxpayer under the same conditions in the absence of such arrangement.

Finally, by virtue of specific tax provisions, transactions (e.g., expenses) between domestic entities and entities of non-cooperative states or states with beneficial tax regimes (e.g., offshore entities) are not recognised for income tax purposes.

At an EU level, the Economic and Financial Affairs Council adopted Council Directive 2018/822/EU amending Directive 2011/16/EU as regards mandatory information on automatic exchange of reportable cross-border arrangements. The main purpose of this framework, known as DAC6, is to provide a mechanism that will enhance and increase tax transparency throughout the EU as regards tax-aggressive cross-border arrangements, which effectively result in tax avoidance. Each Member State must implement DAC6 into their domestic laws and regulations by 31 December 2019 and be in position to apply the new mandatory disclosure rules by 1 July 2020.

At a global level, according to the provisions of the Multilateral Convention to Implement Tax Treaty-related measures to prevent Base Erosion and Profit Shifting (MLI) and Action 6 OECD/BEPS, separate rules are proposed to address situations of treaty abuse (treaty shopping for technical tax avoidance). These include:

a a general anti-abuse rule based on the principal purpose of transactions and arrangements, according to which Member States could deny the application of the preferential provisions of a bilateral treaty when transactions or arrangements are entered into the application of a treaty to only obtain the tax benefits of these provisions in inappropriate circumstances (i.e., technical arrangements);

b a principal purpose test (PPT), according to which, having regard to all relevant facts and circumstances, obtaining a tax benefit is one of the principal purposes of any arrangement or transaction that results directly or indirectly in this benefit, unless it is established that granting this tax benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the covered tax agreement. The benefit under this Convention is not granted if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining this benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly...
in that benefit. In this case, a case-by-case analysis, based on what can reasonably be considered to be one of the principal purposes of transactions or arrangements, is required; and

c
simplified limitation on benefits (LOB) provisions. The MLI does not include a detailed LOB provision given the substantial customisation required by Member States. Instead, the MLI allows parties who prefer to address treaty abuse by adopting a detailed LOB provision to opt out of the PPT and agree to ‘endeavour to reach a bilateral agreement that satisfies the minimum standard’. In addition, the MLI allows parties who prefer a detailed LOB provision to express their intention to incorporate the PPT as an interim measure while the detailed LOB provision is bilaterally negotiated. In particular, for a special purpose vehicle, fund or holding company, the above limitation could arise if a significant percentage of the ultimate beneficial owner does not qualify for the tax relief that the legal entity seems to qualify.

Greece seems to opt for the PPT rule. Therefore, even if the other jurisdiction chooses the LOB provisions, the PPT rule will apply if the source country (place of payment) is Greece. The MLI will apply after being ratified and incorporated in the domestic legal framework of each jurisdiction. Currently, the Greek tax administration is not yet familiar with MLI framework, as it is not yet applicable in everyday practice and has not been implemented.

iv Infringements of tax avoidance (Article 66 of the TPC)

Under Article 66 of the TPC, a taxpayer is considered to have committed the main offence of tax evasion in the following cases:

a. Where the taxpayer conceals from the tax authorities taxable income from any source or assets, in particular by failing to submit tax returns, by submitting inaccurate tax returns, by recording (totally or partially) fictitious costs in his or her accounting records, or by using such fictitious costs so as not to disclose or to disclose reduced taxable income with the intention of avoiding paying income tax, property tax or special property tax.

b. Where the taxpayer fails to make payment, makes incorrect payment, offsets or incorrectly deducts taxes or misleads the tax authorities by presenting false facts as real or by concealing real facts by which he or she fails to make payment, makes incorrect payment or offsets or incorrectly deducts taxes or incorrectly receives a tax refund, or makes a tax withholding with the intention of avoiding paying VAT, turnover tax, insurance premium tax, withholding tax and contributions.

c. Where the taxpayer fails to make payment, or makes incorrect payment, of the special vessels tax, with the intention of avoiding paying such tax.

V TAX COMPLIANCE

In the context of the continuous improvement of international tax compliance, the Greek Law No. 4493/2017 ratified the memorandum of understanding between the governments of Greece and the United States on the improvement of international tax compliance, and the implementation of the Foreign Account Tax Compliance Act on preventing tax evasion. Greece and the US agreed on the automatic exchange of information on financial accounts held by Greek tax residents in US financial institutions and financial accounts held by US tax residents in Greek financial institutions.
In addition, in the context of mutual administrative assistance and cooperation in tax matters on an international and EU basis (OECD, EU) for the automatic exchange of information, Greece has adopted the global standard for the automatic exchange of information of financial accounts (the Common Reporting Standard (CRS)). By virtue of Law No. 4378/2016 (Government Gazette A 55/106), amending Law No. 4170/2013, Greece implemented Council Directive 2014/107/EU ‘amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation’, adopting the use of CRS at European level. By virtue of Law No. 4428/2016 (Government Gazette A 190/2016), Greece ratified its participation in the Multilateral Competent Authority Agreement on the automatic exchange of financial account information. According to the new provisions, financial institutions and tax residents in Greece must adopt specified due diligence procedures for the purpose of identifying bank accounts of individuals and legal entities and report their findings annually to the Ministry of Finance.

VI OUTLOOK AND CONCLUSIONS

Wealth and succession planning for high net worth individuals is in demand in Greece. Greece has entered into many DTTs. Trusts are now recognised as taxable legal entities for corporate income tax purposes and are commonly used as a vehicle for wealth and succession planning purposes. It is also important to note that shipping companies operating under Law No. 27/1975 are attractive to wealthy individual for use as vehicles for Greek tax purposes because they fall under a beneficial tax regime.

On the other hand, new tax provisions have been introduced, such as the CFC rules and other ‘tax evasion’ or ‘artificial arrangement’ provisions, with the aim of addressing tax evasion and preventing techniques that lead to a tax advantage. In line with the aim of these provisions, Greek tax authorities have been adopting a stricter attitude and policy towards any kind of tax planning.
I  INTRODUCTION

Guernsey is part of the Bailiwick of Guernsey, within the Channel Islands. It is located 164 miles south-west of London and 27 miles from the Brittany coastline of France, with a population of 63,000 people. The other islands in the Bailiwick are Alderney, Sark, Herm, Jethou and Brecqhou.

Constitutionally, Guernsey is a dependency of the British Crown having its own parliament, the States of Deliberation, but is reliant upon the United Kingdom for foreign representation and defence. The States of Deliberation generally meets on a monthly basis and consists of 38 deputies elected in districts, plus two representatives from the States of Alderney, a presiding officer (the Bailiff, or the Deputy Bailiff in his or her absence) and two law officers of the Crown (being Her Majesty’s Procureur (Attorney General) and Her Majesty’s Comptroller (Solicitor General)). Other than the deputies, the appointments are made by the Crown. There are no political parties and Guernsey deputies are elected for a period of four years. The Bailiff is also the senior judge of the Bailiwick. The Queen also appoints a Lieutenant Governor, who is her personal representative in the Bailiwick.

The States of Deliberation elects a president who is the most senior political office holder and chairs the policy and resources committee. This committee has oversight of six principal committees and a number of associated authorities, boards and commissions.

Guernsey enjoys a unique relationship with the European Union, along with the two other Crown Dependencies, the Isle of Man and Jersey. Under the terms negotiated by the UK in 1971, Protocol 3 of the Treaty of Accession, Guernsey is within the common customs territory of the community. This means that goods exported from Guernsey into the EU are not subject to the common customs tariff. For all other purposes, Guernsey is outside the EU, but EU directives, which are binding on Member States, may be brought into force in the Bailiwick by an ordinance passed by the States of Deliberation if they are thought to be of value to the Bailiwick. Guernsey has a representative office in Brussels. Following the UK’s Brexit referendum on 23 June 2016, the Policy and Resources Committee issued a statement pointing out that Guernsey remains a ‘third country’ in the EU, with market access to the EU in a number of areas. Negotiations with the UK are being held to:

a protect Guernsey’s interests in the UK exit agreement with the EU;
b replace Protocol 3 in the new UK–EU relationship;

1 Keith Corbin is executive chairman and Mark Biddlecombe is in-house legal counsel at Nerine Trust Company Limited.
2 Treaty of Accession of the United Kingdom to the EEC signed 22 January 1972.
3 European Communities (Implementation) (Bailiwick of Guernsey) Law 1994.
Guernsey’s long-standing constitutional relationship with the UK; and
seek new opportunities as the UK establishes new trading relationships with the rest of
the world.

Guernsey law has its origins in Norman law, the Bailiwick having been part of the Duchy
of Normandy since 993, but in 1204 gained the right to self-government after pleading
allegiance to King John as he fought to maintain his territory in France.

The legal system has subsequently been increasingly influenced by English law, and the
Guernsey courts will refer to case law from England and other common law jurisdictions,
with the Privy Council being the highest court that may deal with Guernsey court matters.

Today, Guernsey is regarded as a pre-eminent international financial jurisdiction
and a centre of excellence for wealth-planning matters. In addition, it has a long-standing
reputation for political stability.

Guernsey’s regulatory standards have received global recognition through a succession
of reviews since 1997 and meeting international standards set by bodies such as the Financial
Action Task Force and the IMF. The report into the most recent international assessment
undertaken by MONEYVAL in 2014 was highly positive and found that Guernsey had
surpassed the standards set in the equivalent IMF report on Guernsey in 2010. Guernsey has
subsequently implemented harsher penalties for financial crime in line with recommendations
in the MONEYVAL report.

The solid legal, political and regulatory platform is supported by a strong financial
services infrastructure including international standard accountancy and law firms, a banking
industry represented by leading international institutions, and other important support
sectors such as insurance and investment management services.

Since the late 1960s, when financial institutions and professional advisers first began
to recognise the potential for Guernsey as an international financial centre, Guernsey has
pursued a conservative and long-term approach to its position as a financial centre, resulting
in state-of-the-art financial legislation that has evolved to meet the demands of international
ultra-high net worth individual (UHNWI) clients.

As a jurisdiction, it offers world-class expertise for international clients and their
wealth planning needs, but is also attractive to UHNWI clients as a home. A simple, low-tax
environment (see below) is underpinned by good transport links with the UK by air and sea,
international telecommunication standards and high-quality education and public services.

II TAX

Guernsey’s domestic budget is funded primarily by income tax receipts, supplemented by
indirect taxes such as import duties on alcohol, tobacco and motor fuel. Property taxes are
charged but at far lower rates than in many other countries.

i Individuals

Personal income tax is charged at a rate of 20 per cent on an individual’s worldwide income.
However, during a tax year persons who are ‘resident’ (spend at least 91 days in Guernsey)

but are not ‘solely resident’ or ‘principally resident’ (broadly meaning they spend 182 days
or more in Guernsey) may elect to pay income tax only on Guernsey-source income plus an
annual ‘standard’ charge of £30,000 in respect of non-Guernsey source income.

Guernsey-resident individuals may also elect to cap their income tax liability by paying
£110,000 on non-Guernsey-source income or £220,000 on their worldwide income.

Guernsey does not levy:

- capital gains tax;
- inheritance tax;
- goods and services tax or value added tax; or
- wealth tax.

ii Corporate
Companies do not generally pay income tax on their profits as the standard rate of company
tax is zero per cent. However, income from financial services (e.g., from banking, fiduciary
and insurance business) is subject to a 10 per cent rate, and income from certain other
sources, including ‘large retail business’ and utility providers, is subject to a 20 per cent rate.

iii International agreements
Guernsey has a policy of meeting internationally accepted standards on tax transparency. As
at 8 June 2018, Guernsey had signed 60 tax information exchange agreements (TIEAs) and
double taxation agreements (DTAs) were in force with 25 countries.5

III SUCCESSION
Before the Inheritance (Guernsey) Law 2011 (the Inheritance Law) came into force on
2 April 2012, Guernsey’s succession law retained aspects of its Norman law origins and
testamentary freedom was limited in a way that would be familiar to its European neighbours.
The Inheritance Law is now more in keeping with Guernsey’s status as a pre-eminent trust
jurisdiction.

Testamentary freedom and the rules on intestate succession vary according to whether
or not the individual is domiciled in Guernsey, whether the estate consists of movable or
immovable property and, in the case of immovable property, whether that property is situated
in Guernsey or otherwise.

For wills executed from 2 April 2012, a Guernsey-domiciled settlor will have complete
testamentary freedom. There are safeguards for family and dependants in that the Inheritance
Law allows defined persons to apply to the court if they feel that they have not been reasonably
provided for in the will.6

Where the individual is domiciled outside Guernsey, the law of their domicile will
govern their estate in relation to realty outside Guernsey and all personal property. If that law
includes forced heirship provisions, then those provisions will have effect.

Guernsey law will, however, apply in relation to any realty situated in Guernsey.

5 A list of TIEA and DTA partner countries is located at www.gov.gg/tiea and www.gov.gg/dta.
6 Inheritance (Guernsey) Law 2011, Section 4(2).
i  Estate administration
When an individual dies leaving assets in their own name in Guernsey, their executor or personal representative will have to apply for a grant of probate (if there is a valid will in existence) or a grant of administration (where the deceased has died intestate). Assets held in joint names will generally pass to the survivor.

Unusually, the issue of a grant in Guernsey remains a matter for the Guernsey Ecclesiastical Court, a jurisdiction long since handed over to the civil courts on the mainland. In order to obtain the grant, the executor or administrator will generally have to appear in person or be represented by their duly appointed attorney.7 The exception to this is where the estate consists of Guernsey realty; this passes automatically on death to the lawful heirs, be that on intestacy or under the terms of a valid will.

ii  Matrimonial issues
In matrimonial matters, Guernsey has modelled its approach on the equivalent legislation in the UK, and the court can be expected to take a similar approach in dealing with financial provision orders and the like. As a matter of principle, while Guernsey legislation recognises that pre- and post-nuptial contracts exist, the court retains a discretion to vary or ignore them as it sees fit, in much the same way as its English counterpart. With a growing acceptance in England that prenuptial contracts have a role in divorce proceedings, the expectation is that Guernsey will follow suit,8 particularly when the parties are from a civil law tradition. If such a contract is recognised under the law of the testator’s domicile, then clearly it will have an effect on dealing with their personalty and non-Guernsey realty.

From 2 May 2017, same-sex marriages have been permitted in Guernsey.9 Guernsey does not permit same-sex civil partnerships, but does recognise certain overseas civil partnerships and registered overseas relationships.

Guernsey has long been an attractive destination for high net worth individuals looking for a place to live that is familiar, close to major markets and fiscally benign. Guernsey’s modernised succession law, increased recognition of diversity, and a modern flexible approach to matrimonial assets will add to its attractiveness. In a political climate where tax rates in the major economies remain high and the attractiveness of the UK for high net worth non-domiciliaries continues to be eroded, Guernsey is well placed to benefit.

IV  WEALTH STRUCTURING
Since the 1960s, Guernsey has demonstrated a willingness to adapt and innovate in order to meet the needs of an increasingly sophisticated and global market for wealth structuring, whether that be in its state-of-the-art trust law, its world-class collective investment regime or its continuously evolving company law.

Guernsey trust law was first codified in 1989, and then given a significant facelift in 2007. Since then, Guernsey has introduced a foundations law, an image rights registry (the

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7  It is possible instead to arrange for a postal oath to be sworn before a notary public or the equivalent.
8  See, for example, E v. E (Royal Ct.), 2003–04 GLR N [22] where the issue was not about policy, but about the circumstances under which the contract was entered into.
first anywhere in the world), and an aircraft registry. It also continues to develop its company law for an increasingly international market. Guernsey’s latest focus is on promoting itself as a leading jurisdiction for fintech and digital businesses.

Guernsey in 2018 is very much a first-rank international finance centre. The island has become a centre of excellence for fiduciary services, with access to first-rate law firms, accountants, banks and investment managers. The political system is stable, and the judiciary is extremely well versed in dealing with very complex and high-value commercial and fiduciary matters. In September 2017, after seven years of legal proceedings, a judgment running over 500 pages was handed down by the Royal Court in a case valued at well over £1 billion, thought to be the biggest trial that took place across the Commonwealth in 2016.\textsuperscript{10}

While continuing to service institutions and advisers in London, Guernsey has a global significance. Service providers on the island have a distinct awareness and sensitivity to the needs of clients from very different cultures, with consumers of Guernsey fiduciary services coming from Asia, the Middle East, Eastern Europe and Latin America as much as from western European economies and the United Kingdom.

i  
**Trusts**

Guernsey trust law has developed from its English law roots to include features that are essential to meet the needs of this global client base, while retaining the fundamental characteristics of trust principles. As well as a growing body of precedent of its own, Guernsey can also look to other common law jurisdictions for guidance on legal principles, and with the Privy Council as its ultimate appellate court, has access to the leading judicial minds in the field. Guernsey’s trust law has a number of features that are designed to provide solutions for its global audience. Examples of Guernsey’s approach include the following.

**Duration**

Guernsey law does not have perpetuities and accumulations restrictions as evident on the mainland and allows for trusts of unlimited duration.

**Purpose trusts**

A Guernsey law trust can be established for charitable or non-charitable purposes. This can be particularly useful for structuring family businesses, commercial structures or in a private trust structure as discussed later in this chapter. An enforcer must be appointed to a purpose trust to hold the trustee accountable.

**Reserved powers**

One of the challenges that settlors face when they establish a trust is to play an ongoing role in the administration of the trust without compromising the benefits that it provides. Under Guernsey law, settlors can reserve to themselves, or to others, a wide range of powers such as powers to:

\begin{itemize}
  \item[a] revoke or vary the trust;
  \item[b] appoint income or capital;
  \item[c] direct investments;
\end{itemize}

\textsuperscript{10} Carlyle Capital Corporation Limited (in liquidation) and others v. Conway and others (Royal Court, 4 September 2017).
d appoint or remove trustees and directors of underlying companies;
e change the proper law; and
f veto trustee decisions.

**Trustee liability**

Trustees of a Guernsey trust have a wide range of duties under the law, including a duty (subject to the terms of the trust) to preserve and enhance the value of the trust, so far as is reasonable. There is also an overarching duty to act in the utmost good faith and ‘en bon père de famille’.\(^{11}\) Trustee liability can be excluded under the terms of the trust, but not so as to exclude liability for fraud, wilful misconduct or gross negligence. The recent Privy Council decision on 23 April 2018 in *Investec v. Glenalla* [2018] UKPC 7 reaffirms that creditors of the trustee do not have direct recourse against trust assets, even if the trustee loses its right of indemnity against the trust assets (for example, if it has acted in breach of trust). This will give settlors of Guernsey trusts a great deal of comfort.

Claims for breach of trust must be brought within three years of the claimant becoming aware of the breach or they will be prescribed.\(^ {12}\) Prescription differs from limitation under English law in that it operates to extinguish a claim, rather than denying relief from the claim.

**Dispute resolution**

Guernsey has recognised that where breach-of-trust claims are made against trustees, it is important that any settlement reached between the parties outside the court room has legal and binding effect. The 2007 law therefore provides, with appropriate safeguards, for claims settled under alternative dispute resolution to be binding against all beneficiaries of the trust, whether yet ascertained or in existence.\(^ {13}\)

**Company law**

Guernsey’s company law continues to evolve, with the latest significant amendments set out in the Companies (Guernsey) Law 2008 (Amendment) Ordinance 2015, which came into effect on 3 September 2015.

Among the many changes introduced, is an ability for a Guernsey company to be incorporated with, or register, an alternative name expressed in non-Roman alphabet, characters or script. This was in response to demands from clients in East Asia and the Middle East. Other measures included provisions to align Guernsey’s legislation with the UK’s City Code on Takeovers and Mergers.

Given the number of Guernsey companies that list on the London Stock Exchange, there is a clear need for the company law to remain modern and flexible.

\(^{11}\) This is a customary law principle, particular to Guernsey’s law. In trust law the Privy Council determined in *Spread Trustee Co Ltd v. Hutcheson* [2011] UKPC 13, that it was analogous to the English law prudent investor test.

\(^{12}\) The case of *Broadhead v. Spread Trustee Company Limited & Ors* (Guernsey Judgment 46/2014) determined that the clock starts to run once the claimant has enough information that would make any reasonable person begin to investigate whether there had been a breach of trust. They would see that a loss has been incurred, and have a sense that there was a real possibility (not a mere suspicion) that the loss had been caused by negligence on the part of the trustees.

\(^{13}\) Trusts (Guernsey) Law 2007, Section 63.
Incorporation in Guernsey is quick and easy with the use of Guernsey's online registry through licensed providers. A company can be incorporated within a day and, for a modest premium, in less than two hours.

In 1997, Guernsey was the first jurisdiction to introduce the concept of the protected cell company, with a further innovation in the shape of the incorporated cell company (ICC) following in 2006. Both are attractive in collective investment and insurance situations, allowing segregation and insulation of assets as between cells in the company, with the principal difference being the need for cells in an ICC to be separately capitalised.

Guernsey law also provides for companies to be limited by guarantee, a facility that is particularly helpful in structures where there is a need for an orphan vehicle.

The recent case of Carlyle Capital Corporation Limited (in liquidation) and others v. Conway and others [2017] comprehensively considered the duties of directors of Guernsey companies and reaffirmed the duty of directors to act in the best interests of the company.

### iii Limited partnerships
Limited partnerships established under the Limited Partnerships (Guernsey) Law 1995 are widely used in Guernsey for collective investment schemes and in private family arrangements where the tax consequences of establishing a trust would be unattractive. They allow a separation between ownership of an asset – such as a family business – and its control. Partners have the ability to elect for the partnership to be a body corporate, with separate legal personality.

The limited partnership will generally be a look-through entity, made up of a general partner (often a corporate) and one or more limited partners. The general partner holds the assets of the partnership and they are under its control. The profits of the partnership are allocated to the partners under the terms of the partnership agreement, which is not publicly filed, allowing the terms to remain confidential to the partners.

Limited liability partnerships have been available since 2014, following the enactment of the Limited Liability Partnerships (Guernsey) Law 2013. A limited liability partnership may be a useful vehicle for authorised or unauthorised collective investment fund structures, or for professional firms looking to incorporate for the purposes of limited liability.

### iv Foundations
While trusts remain very important for Guernsey, it is not always easy for civil law clients to embrace the concept. In civil law countries, including many of the emerging markets (Brazil, Russia and China to name but three), the foundation may be more familiar and easier to accept.

With these issues in mind, and with an eye on some of the lessons learned in neighbouring jurisdictions, the Foundations (Guernsey) Law 2012 came into force on 7 January 2013.

The foundation is in some ways a hybrid between a trust and a limited company (often referred to as an ‘incorporated trust’). Like a company, the foundation has separate legal personality, a certificate of incorporation, a registered number and a Guernsey registered office. There is public certainty as to the foundation’s existence – a foundation cannot fail if it has no assets – like a company it can be ‘re-capitalised’ by an additional endowment.

A foundation is established under a charter, which has two parts: Part A is public and includes basic details of the foundation; Part B is maintained by the registrar but in strict confidence and will include a statement of the purpose of the foundation. This latter provision was included as a regulatory safeguard.
The other core document for the foundation is the rules. These are not registered and remain completely confidential between the founder and the council. The purpose of the rules is to set out how the foundation is going to operate.

All foundations must have a purpose, which may be charitable or non-charitable and can be drafted as widely as required. The foundation may also have beneficiaries, and if it does these can be enfranchised, with a right to information in respect of the foundation like a trust beneficiary, or disenfranchised, with no right to information.

Whenever there are disenfranchised beneficiaries, or if there is only a purpose, a guardian must be appointed with responsibility for holding the council to account.

Foundations are utilised as:

a part of a succession-planning structure for private families – be that a structure that includes a trust or as a substitute for a trust;

b vehicles for charitable donations; and

c orphan vehicles in corporate structuring, as opposed to using a purpose or charitable trust.

v Private trust company structures

As noted earlier, the Trusts (Guernsey) Law 2007 includes provisions allowing the settlor to reserve a broad range of powers. This allows settlors a degree of control over trustee actions and decisions without compromising the fundamental validity of the trust.

For a number of reasons, this may not always be the preferred approach, and may not go far enough in terms of giving the family the degree of influence and control over trustee decisions that they would like to have.

The solution for many families is to establish a private trust company (PTC) under their control to act as trustee of trusts established only for the family. Guernsey allows such a company to act outside the regulatory licensing regime so long as the PTC does not receive any remuneration.

The PTC allows the family to influence and control the structure in a number of ways:

a The family can retain the ability to nominate directors of the PTC to sit alongside directors from the service provider and other professional advisers. These family nominated directors will often be members of the family.

b The trust can still include reserved powers, giving the settlor additional comfort in relation to key decisions.

c The settlor can provide the board of the PTC with guidance on an ad hoc basis or through a letter of wishes.

d The settlor or family can control the composition of the board of subsidiary companies held by the trust.

e The settlor or family can establish a set of rules dictating how the PTC should be run and how key decisions should be made through the drafting of the constitutive documents of the PTC alongside other documents, such as a family charter.

It is a lot easier for the family to change the composition of the board of directors of the PTC than it would be to remove and replace an independent trustee appointed in the more usual fashion.

When establishing a PTC structure, it is important that the family considers how the PTC should be owned. Traditionally, the PTC would be a company owned by a purpose trust. Alternatively, the PTC can be structured as a guarantee company, although care will need to be taken in order to ensure issues in relation to succession to guarantee membership.
are considered. More recently, foundations have been used instead of the purpose trust to own the PTC. Alternatively, the PTC can simply be established as a foundation (known as a private trust foundation).

V REGULATION

Guernsey has been at the forefront of the regulating and licensing fiduciary service business. Alongside Jersey, it was the first jurisdiction to introduce legislation for the licensing of fiduciaries in 2000.14

Under the auspices of the Guernsey Financial Services Commission (GFSC), fiduciary, banking and insurance businesses in Guernsey are subject to a state-of-the-art regulatory regime. The GFSC operates a risk-based approach to regulation. Licensees are all risk-assessed and subject to regular visits from and reviews by the regulator.

All licensees are required to abide by core principles set out in the legislation, related rules, codes of practice and guidelines.

Guernsey has a comprehensive suite of legislation in relation to anti-money laundering (AML) and prevention of the financing of terrorism, in keeping with the highest levels found internationally. A principal function of the GFSC is to ensure that licensees adhere to the requirements of the legislation and there is a separate division dealing with financial crime and a further division focused on enforcement. The common theme of the 2017 annual report across all divisions of the GFSC was that licensees strengthen their controls against cybercrime, especially in relation to client data security.

The States of Guernsey is committed to ensuring that Guernsey is a centre of excellence for future digital technology, developing new and innovative businesses through research and development in sectors such as fintech, data storage and analytics, cybersecurity, institutional peer-to-peer lending, digital transactions, including blockchain, and wealth-management platforms. Of particular note during 2018 is Guernsey’s revised data-protection regime enacted in the Data Protection (Bailiwick of Guernsey) Law 2017 (which adopts the EU General Data Protection Regulation (GDPR) into local law). Under the new law, which came into effect on 25 May 2018, all individuals (not just those located in the EU as mandated by GDPR) whose data is processed in Guernsey will be subject to strengthened data-security protections.

Taken as a whole, the regulatory regime is a significant factor in Guernsey’s status globally and explains why Guernsey has received such positive reviews from the likes of MONEYVAL.

As ever, the regulatory environment does not stand still and the GFSC is working on a number of initiatives, including revisions to the AML handbook and a comprehensive revision of the regulatory laws. In addition, Guernsey is also looking to reform its insolvency laws and legislation is in the process of being drafted.

Guernsey, like most other jurisdictions in the world, is also actively involved with the increased degree of reporting and sharing of information in response to the Foreign Account Tax Compliance Act and Common Reporting Standard. Guernsey will be playing its full part in the process of ensuring that its tax neutrality continues to operate in a way that is consistent with international law.

14 The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc., (Bailiwick of Guernsey) Law 2000.
The UK has been leading the charge on requiring the disclosure of beneficial owners of corporate structures, implementing a private register of trusts with a UK connection during 2017 and looking to expand its public register of beneficial ownership of UK companies to include non-UK entities owning UK real estate. Guernsey introduced its central register of beneficial ownership in relation to Guernsey entities on 15 August 2017. In contrast to the UK’s company beneficial ownership register, which is publicly available and searchable, Guernsey’s register is centrally maintained, but the information on it is not publicly available. Instead, it is only available to certain Guernsey regulatory and law enforcement bodies (who will be able to disseminate this information to their counterparts in other countries when requests for such assistance are received). This is in line with Guernsey’s commitment to maintaining the privacy of clients of Guernsey businesses and promoting the security of their data.

VI OUTLOOK AND CONCLUSIONS

From its beginnings in the 1960s, Guernsey has emerged as a major player in international finance. It has moved with the times, adapting its approach and its legislation in order to meet the ever-changing demands of its international client base and a rapidly evolving global approach to economic and fiscal change.

With the increasing global tension between protecting the privacy of client data and disclosing who beneficially owns corporate vehicles, clearly Guernsey will need to continue to innovate in order to remain competitive while being recognised as a good global citizen. Its track record for over 50 years gives every reason for confidence that Guernsey is well placed to meet that challenge.
I INTRODUCTION

Hong Kong, formally known as the Hong Kong Special Administrative Region of the People’s Republic of China, is in a unique position: although it is part of China, it has a separate and different legal system. This system is called ‘one country, two systems’. As a former British colony, Hong Kong inherited the English common law system and much of Hong Kong’s legislation is based on English legislation. Article 5 of the Basic Law2 allows Hong Kong to maintain its separate legal and judicial system for 50 years after its handover back to China on 1 July 1997. Chinese and English are both official languages of Hong Kong.

Apart from having a separate legal system from China, Hong Kong also has a separate financial and banking system, which is regulated by the Hong Kong Monetary Authority. Hong Kong continues to be a major financial centre and plays a major role in the world’s financial industry. According to figures released by the Hong Kong Stock Exchange, Hong Kong recorded 174 initial public offerings (IPOs), raising HK$128.2 billion during 2017.3 For the 16th consecutive year, the Hong Kong market was one of the world’s top five in IPO fundraising. Hong Kong is also one of the most free economies in the world, making it attractive and easy for businesses to set up in Hong Kong. Following its 2018 ranking, Hong Kong has been ranked the number one country on the Index of Economic Freedom for the past 24 years.4

Hong Kong has one of the highest concentrations of high net worth individuals in the world. It is the only city in the world that has its own separate Forbes ‘rich list’. In addition to Hong Kong’s own high net worth individuals, China’s high net worth individuals are also increasingly turning to Hong Kong, not only for the shopping, but also for their succession and estate planning needs. An increasing number of Chinese companies have also applied for listing in Hong Kong, especially after the relaxation of rules in China in 2013, which made it easier for Chinese companies to list on the Hong Kong Stock Exchange. This makes Hong Kong not only the gateway to China, but also the gateway from China to the outside world.

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1 Ian Devereux and Silvia On are partners at Stephenson Harwood.
2 Article 5, The Basic Law of the Hong Kong Special Administrative Region of the People’s Republic of China.
II TAX

i Taxation in Hong Kong

Unlike many other jurisdictions, Hong Kong has a territorial taxation system that means Hong Kong only imposes tax on income and profit arising in Hong Kong. Therefore, in most cases, the issue of whether an individual or company is subject to Hong Kong tax depends on whether the income or profit arises in or derives from Hong Kong.

The two main pieces of legislation dealing with taxation in Hong Kong are the Inland Revenue Ordinance (IRO) and the Stamp Duty Ordinance (SDO). The main forms of tax imposed in Hong Kong are set out below.

Salaries tax

As its name suggests, salaries tax is imposed on salaries received by individuals – an individual is subject to salaries tax if he or she receives income arising in or derived from Hong Kong from any office, employment of profit or pension.5 The tax residency of an individual is usually irrelevant when determining whether an individual is subject to Hong Kong salaries tax.

Salaries tax is essentially the only form of income tax levied on an individual and, unlike some other jurisdictions, Hong Kong does not have a general income tax that is imposed on the individual’s income. Where an individual also receives other forms of income, such as rental income, this rental income is subject to property tax (see below), but the individual can elect for ‘personal assessment’ of his or her total income where he or she will be taxed based on the aggregate total of his or her income.

Individuals are taxed at either a progressive rate, ranging from 2 per cent to 17 per cent, or a flat rate of 15 per cent depending on which method of calculation provides the lower amount of tax payable. When determining the income taxable under either salaries tax or personal assessment, the individual’s allowable allowance (such as personal allowance and child allowance) and allowable deductions (such as contribution to the Hong Kong mandatory pension scheme and donations to charities) are deducted from the individual’s total income.

Also, unlike many other jurisdictions, the taxes payable by an individual (either under salaries tax or personal assessment) are not deducted at source (i.e., not deducted prior to payment to the individual by the employer). An individual is responsible for paying his or her taxes to the Hong Kong Inland Revenue Department (IRD). Every year, the Hong Kong IRD issues a notice of assessment to individuals and individuals are required to complete and file the notice of assessment to the Hong Kong IRD. The Hong Kong IRD will then calculate the amount of salaries tax payable by the individual.

Other forms of income received by individuals such as dividends, interest and distributions from trusts are not usually subject to tax in Hong Kong.

Profits tax

Profits tax is imposed on every person who is carrying on a trade, profession or business in Hong Kong in respect of the profits arising in or derived from Hong Kong from the carrying on of the trade, profession or business in Hong Kong.6 Therefore, profits tax is often seen to be similar to corporate tax. Like salaries tax, the tax residency of the company

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5 Subsection 8(1), Inland Revenue Ordinance (Cap 112).
6 Subsection 14(1), Inland Revenue Ordinance (Cap 112).
is usually irrelevant when determining whether a company is subject to Hong Kong profits tax. However, issues such as where the directors are based and where the directors’ meetings are held are relevant factors when it comes to determining whether the profit is arising in or derived from Hong Kong. The company’s place of incorporation is also irrelevant when determining whether a company is subject to profits tax, although it is generally assumed that a Hong Kong company will be subject to profits tax and therefore the Hong Kong IRD will send Hong Kong companies a profits tax return every year for assessing the profits tax payable by the company. The current rate of profits tax is 16.5 per cent.

A ‘person’ is defined widely to include a corporation, partnership, trustee, whether incorporated or unincorporated, or body of persons.\(^7\) The inclusion of ‘trustee’ but not ‘trust’ in the definition of a person and the wording of the profits tax charging provision makes it unclear whether the trustee of a trust, particularly in relation to discretionary trusts, will be subject to profits tax on the trust income because any profit generated by the trustee as the trustee of a trust belongs to the trust and not the trustee. Where the trust is a bare trust, the profit is considered as belonging to the beneficiary and therefore it is the beneficiary who will be subject to profits tax on the profit, not the trustee.\(^8\)

Like individuals, income in the form of dividends and interest is not usually subject to tax.

**Property tax**

Property tax is a tax imposed on the net assessable value of land and buildings in Hong Kong. Net assessable value is calculated based on the consideration received for the use of the land or building less any allowable deductions. In other words, property tax is charged on rental income received less allowable deductions. The current rate of property tax is 15 per cent.

Where the land or building is owned by a corporation and the rental income received by the corporation is subject to profits tax, the corporation can apply for exemption from property tax.

**Stamp duty**

The SDO imposes stamp duty on leases of Hong Kong immovable property, transfer of Hong Kong immovable property and transfer of Hong Kong stocks such as shares.\(^9\) The rate of stamp duty on leases depends on the length of the lease and the annual rental payable under the lease. The rate of stamp duty on the transfer of Hong Kong immovable property depends on the value of the property transferred or the market value of the property transferred as assessed by the Hong Kong IRD. The rate of stamp duty on Hong Kong stocks is usually 0.1 per cent of the amount of consideration paid and 0.1 per cent of the consideration received payable by the transferee and transferor respectively.

In the past few years, as part of an effort by the Hong Kong government to cool rising property prices in Hong Kong, a number of additional stamp duties have been imposed in relation to immovable property transactions. A special stamp duty is imposed on individuals and companies that resell residential property within 36 months of purchase. The rate of stamp duty depends on the length of time the property was held for before it is resold.

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7. Section 2, Inland Revenue Ordinance (Cap 112).
9. Section 4 and First Schedule, Stamp Duty Ordinance (Cap 117).
Another stamp duty is the buyer’s stamp duty, whereby a stamp duty of 15 per cent is imposed on companies and non-Hong Kong individuals (i.e., individuals who are not Hong Kong permanent residents) purchasing Hong Kong residential properties. In addition, the ad valorem stamp duty imposed on individuals or companies buying residential properties on or after 23 February 2013 has, since 5 November 2016, been increased to a flat rate of 15 per cent. There is an exemption in that this will not apply where the purchaser is a Hong Kong permanent resident, does not own other residential properties in Hong Kong (at the time of the purchase) and acquires only one residential property under a single instrument. Where the individual purchases a second residential property and subsequently sells the first residential property within 12 months, the purchaser will be rebated the additional higher rate of stamp duty paid, in other words, they will only have to pay the normal rate of stamp duty instead of the higher rate of stamp duty.

Other taxes
Hong Kong does not have gift tax, estate duty (which was abolished in 2006) and capital gains tax. Although Hong Kong does not have capital gains tax, gains made from the trading, such as buying and selling of shares or properties, may be considered to be profit and therefore be subject to Hong Kong profits tax. Hong Kong also does not have any form of sales tax, such as goods and services tax, and value added tax.

ii Cross-border issues
Hong Kong’s territorial system of taxation means that an individual’s tax residency and domicile are usually not relevant when determining taxability; hence there is no definition for tax residency under the IRO and a lack of case law on the issue of tax residency. In relation to companies, the company’s tax residency is also not usually relevant when determining taxability. This lack of definition of tax residency under Hong Kong law may create issues when dealing with certain cross-border issues because international agreements such as double tax treaty agreements use the concept of tax residency when determining taxability. However, the Hong Kong IRD will issue a certificate of resident status to Hong Kong residents who need proof of resident status.

Since Hong Kong’s return to China, Hong Kong has entered into double tax treaty agreements with 40 countries. Hong Kong has also entered into tax information exchange agreements with the United States and six Nordic jurisdictions. Hong Kong also signed a Model 2 intergovernmental agreement with the United States on 13 November 2014 to facilitate compliance with the US Foreign Account Tax Compliance Act. On 7 June 2017, Hong Kong introduced new legislation expanding the list of reportable jurisdictions for automatic exchange of financial account information from two to 75, and aims to commence the first exchanges by the end of 2018.

10 Hong Kong Inland Revenue Department website (www.ird.gov.hk/eng/faq/#avd).
11 Hong Kong Inland Revenue Department website (www.ird.gov.hk/eng/tax/dta_cor.htm).
12 Hong Kong Inland Revenue Department website (www.ird.gov.hk/eng/tax/dta_inc.htm).
13 Hong Kong Inland Revenue Department website (www.ird.gov.hk/eng/tax/dta_aeoi.htm).
III SUCCESSION

In recent years, Hong Kong has seen a number of wealthy families go through the process of passing wealth from the first generation to the second generation. In a number of cases, this transfer of wealth has ended up with second generation family members going to court to settle their disputes over the distribution of the family wealth, or family members and beneficiaries challenging the validity of wills. These cases have also been widely publicised by the media. This has prompted individuals to consider the need to put in place some form of succession mechanism to ensure the smooth succession of wealth from one generation to the next and to protect the family’s privacy and confidentiality.

Because of the low tax rates in Hong Kong and especially after the Hong Kong estate duty was abolished, tax planning is not usually a driving factor when it comes to estate planning for individuals who are resident in Hong Kong and whose family members are also resident in Hong Kong. For many of these individuals and their families, succession planning and wealth preservation are often the reasons for planning.

i Wills

In Hong Kong, individuals are generally free to decide how their assets are to be distributed through the use of wills since Hong Kong does not have forced heirship rules. However, the Inheritance (Provision for Family and Dependants) Ordinance allows dependants, such as the spouse, former spouse (who has not remarried), parents, offspring and other persons related to the deceased to challenge the deceased’s will on the basis that the disposition of the deceased’s estate under the will, the law relating to intestacy or a combination of both is insufficient to make reasonable financial provision for that person.14

ii Intestacy

Where an individual dies without leaving a will, his or her estate will be distributed in accordance with the Hong Kong intestacy rules set out in the Intestates’ Estates Ordinance.15 If the deceased leaves a spouse but no issue, parent or sibling, all the assets are inherited by the spouse. If the deceased leaves a spouse with issue, then the spouse will inherit all personal chattels, HK$500,000 and half of the residue estate with the other half of the residue estate going to the issue. If the deceased leaves a spouse with no issue, then the spouse will inherit all personal chattels, HK$1 million and half of the residue estate with the other half going to parents, or siblings if the parents are not living. If the deceased leaves no spouse but issue, then the issue will inherit in equal shares. If the deceased leaves no spouse and no issue, then the parents inherit in equal shares. If there are no parents, then the siblings (failing which grandparents, failing which uncles and aunts) inherit in equal shares.

iii Marital property and divorces

In addition to wanting to prevent family disputes, wealthy individuals and families are also becoming increasingly concerned about the division of assets in the case of a family member getting divorced. The Hong Kong courts have very much followed the approach of the English courts when it comes to determining how matrimonial properties are to be divided in the case of a divorce. The Hong Kong courts will start with the ‘yardstick of equality’

14 Section 3, Inheritance (Provision for Family and Dependants) Ordinance (Cap 481).
15 Section 4, Intestates’ Estates Ordinance (Cap 73).
approach, so the starting point is to assume each party is entitled to half of the matrimonial property.\textsuperscript{16} This approach was also taken in the recent Hong Kong case of \textit{Kan Lai Kwan v. Poon Lok To Otto}.\textsuperscript{17} In relation to prenuptial agreements, Hong Kong courts stated that Hong Kong should follow the principles on prenuptial agreements proclaimed in the English case of \textit{Radmacher v. Granatino},\textsuperscript{18} which means that prenuptial agreements are not legally binding in Hong Kong but are persuasive.\textsuperscript{19}

The Hong Kong courts also recently adopted the test set down by the English courts in \textit{Charman v. Charman}\textsuperscript{20} in determining whether trust assets should be treated as a financial resource. The Hong Kong Court of Final Appeal stated that the test to be applied is ‘to decide whether a discretionary trust is a financial resource of one of the parties, the Court asks whether, if that party were to request the trustee to advance the whole or part of the capital or income of the trust to him or her, the trustee would, on the balance of probabilities, be likely to do so’.\textsuperscript{21} This means that assets held by a trust can be considered matrimonial property and therefore subject to division when parties divorce.

These factors combined with recent high-profile divorce cases involving wealthy families, which were widely reported by the media, have also resulted in wealthy families looking to find ways to protect their family wealth should one of the family members get divorced.

An interesting feature of Hong Kong matrimonial law is that, prior to the passing of the Marriage Reform Ordinance, until 1971 concubines were legally recognised and therefore these concubines and their children also had a legal right to the estate under Hong Kong law.

Hong Kong does not have civil unions or same-sex marriages, but in recent years, there has been increasing interest in this area with certain groups lobbying for the passing of legislation to allow for same-sex marriages.

\textbf{iv Other succession issues}

One issue with Hong Kong having a separate legal system from China is where Hong Kong-resident individuals own assets in China, such as Chinese immovable property. Because of restrictions on the ownership of Chinese assets, it is often difficult if not impossible to transfer these assets into an offshore trust (even if the trust is a Hong Kong trust). This means these individuals often have to deal with the succession of their Chinese assets through a separate Chinese will.

\textbf{IV WEALTH STRUCTURING AND REGULATION}

\textbf{i Commonly used vehicles for wealth structuring}

Offshore trusts and offshore companies are commonplace when it comes to structuring wealth for Hong Kong individuals and families. Hong Kong trusts were not often used because, compared with the trust law of the offshore jurisdictions, the Hong Kong trust law

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{16} See \textit{DD v. LKW} (2010) 13 HKCFAR 537.
\item \textsuperscript{17} (2014) 17 HKCFAR 414, [2014] HKEC 1174, [2014] HKFLR 329.
\item \textsuperscript{18} [2010] UKSC 42, [2011] 1 AC 534.
\item \textsuperscript{19} See \textit{SPH v. SA} [2014] 4 HKC 271.
\item \textsuperscript{20} [2005] EWCA Civ 1606, [2006] 1 WLR 1053.
\item \textsuperscript{21} \textit{Kan Lai Kwan v. Poon Lok To Otto} (n 17) at Paragraph 29.
\end{itemize}
\end{footnotesize}
was considered to be outdated and not as user-friendly. However, since Hong Kong amended its trust law in December 2013, Hong Kong trusts are gaining interest and the use of Hong Kong trusts is becoming more common.

It is also more common to establish private trust companies in these offshore jurisdictions. One reason for this is because offshore companies provide greater confidentiality since Hong Kong companies are required to file information about their shareholders and directors with the Hong Kong Companies Registry, and this information is publicly available. Offshore private trust companies were commonly used to act as the trustee of private unit trusts in trust structures established for Hong Kong estate duty planning.

Hong Kong does not have foundation law and foundations are not as commonly used as trusts for estate planning purposes. One reason for this may be because trusts have always been more widely used and recognised in Hong Kong.

ii  **Hong Kong trusts**

The main piece of legislation governing Hong Kong trusts is the Trustee Ordinance, which was amended in December 2013. The amendment brought in a number of significant changes to the Hong Kong trust law. There is now a statutory duty of care imposed on trustees, whereby trustees are required to exercise a level of care and skill that is reasonable in the circumstances, taking into account the trustees' special knowledge, experience or professional status. A statutory control on trustees' exemption was also added whereby remunerated trustees acting in a professional capacity are not allowed to exclude their liability for wilful misconduct, gross negligence or fraud. A number of provisions relating to trustees' powers and trustees' rights to remuneration were also amended. The new Hong Kong trust law allows the settlor to reserve the investment and asset management of the trust to himself or herself without this invalidating the trust. Foreign forced heirship rules will also not affect the validity of transfer of movable property to trusts that are expressly governed by Hong Kong law. The Perpetuities and Accumulations Ordinance was also amended, abolishing the rules against perpetuities and excessive accumulation of income, which means non-charitable trusts governed by Hong Kong law and set up on or after 1 December 2013 are no longer required to have a perpetuities period and accumulation period. The rule against excessive accumulation of income continues to apply to Hong Kong charitable trusts.

The Anti-Money Laundering and Counter-Terrorist Financing Ordinance (as amended in 2018) established a new regulatory regime for trust or company service providers (TCSPs). From 1 March 2018 onwards, a company that carries out the business of providing trust or company services in Hong Kong must apply for a trust or company service provider licence.
licence (TCSP licence). This includes all companies providing services such as acting, or arranging for another person to act, as trustees of express trusts or as nominee shareholders for companies not listed on a recognised stock market, as well as providing other company services such as incorporating companies, acting, or arranging for another person to act, as director or company secretary of companies or providing registered offices or correspondence addresses. The directors, partners and other controllers of these companies must satisfy a ‘fit and proper test’ and are required to comply with certain statutory customer due diligence and record-keeping requirements.  

In addition to applying for a TCSP licence, some companies that provide trusteeship services also choose to register as a trust company under the Trustee Ordinance. A company applying for registration as a trust company under the Trustee Ordinance must be a Hong Kong public company with an issued share capital of at least HK$3 million, which has to have been fully paid up in cash. The trust company must also satisfy certain other requirements and pay a sum of not less than HK$1.5 million to the director of accounting services as security for the depositors and creditors of the trust company. There are certain activities, such as acting as an executor or applying for the grant of probate of the will or letters of administration of the estate of a deceased person, that a trust company cannot undertake unless it is a registered trust company under the Trustee Ordinance.

Except for the requirement to apply for a TCSP licence, service providers of trusteeship services are largely unregulated in Hong Kong when it comes to them providing trustee services in Hong Kong, unless the company is registered as a Hong Kong trust company under the Trustee Ordinance. Having said that, many of the service providers, such as the subsidiaries of the banks and independent trustee companies, have a tendency to use offshore jurisdictions when establishing trusts and are, therefore, regulated by the relevant authority in those offshore jurisdictions. This lack of barrier to entering into the Hong Kong trust industry may be one reason for the increasing number of offshore independent trustee companies setting up in Hong Kong in recent years.

Regardless of whether an offshore trust or Hong Kong trust is used, there are no legal restrictions on the transfer of Hong Kong assets to entities such as companies and trusts. However, the transfer of certain Hong Kong assets, such as shares in Hong Kong companies and Hong Kong immovable property, will be subject to Hong Kong stamp duty. The introduction of the additional stamp duties on the transfer of Hong Kong properties (as mentioned previously) has made it less attractive for individuals to transfer Hong Kong properties to, or own them through, corporate entities or trusts. The transfer of non-Hong Kong assets such as the shares in an offshore company are, in most cases, not subject to Hong Kong stamp duty or any other form of Hong Kong taxes, since Hong Kong does not have gift tax. This is one of the reasons why it is common to see offshore companies being used as holding companies to hold Hong Kong assets such as shares in Hong Kong companies or Hong Kong immovable properties. As for the general taxation of trusts, see the profits tax section above.

31 Part 8, Trustee Ordinance (Cap 29) as amended by the Trust Law (Amendment) Ordinance 2013.
V OUTLOOK AND CONCLUSIONS

Hong Kong has always been home to a large number of high net worth individuals and their families. Some of these families have already experienced a transfer of wealth from the first generation to the second generation, some more successfully than others. China, on the other hand, has not yet experienced this transition and is therefore increasingly looking to Hong Kong and other countries for successful models, as well as hoping to learn from others’ failures. This has resulted in demand for service providers and advisers who will be able to assist these high net worth individuals and their families with succession and estate planning needs, particularly those who are able to speak Chinese.

Since the amendment of the Hong Kong Trustee Ordinance, there has been increasing interest from service providers and individuals in using Hong Kong law as the governing law of trusts. As mentioned above, trust companies in Hong Kong are largely unregulated other than the requirement to apply for the TCSP licence and, if necessary, for registration as a Hong Kong trust company under the Trustee Ordinance.

Apart from the amendment of the Trustee Ordinance, the Hong Kong company law was also amended and the new Companies Ordinance came into effect on 3 March 2014. The new Companies Ordinance brought in a number of changes, such as the requirement that there be at least one director who is an individual in a private company, which could potentially affect the use of Hong Kong companies when structuring for wealthy individuals and their families.

Hong Kong charities law is also currently largely unregulated and is undergoing reform. The Law Reform Commission of Hong Kong issued a report in December 2013 that set out a number of recommended changes to the Hong Kong charities law, including introducing a clear statutory definition of what constitutes a charitable purpose, requiring charitable organisations that solicit public donation or have sought tax exemption to be regulated, and creating a set of specifically formulated financial reporting standard for charities.

With the new legislation and the entering of more agreements (such as double tax treaties and tax information exchanges) with other countries, Hong Kong is moving towards more regulation and greater transparency.
Chapter 23

HUNGARY

Janos Pasztor

I INTRODUCTION

In recent years, Hungary has been striving to attract foreign affluent individuals by reducing personal income tax and adopting other favourable measures for private individuals, which we detail below.

In March 2014, a new Civil Code, which could significantly improve the legal environment for private wealth planning, entered into force. In this respect, the most significant development of the Civil Code is the Hungarian trust, which was incorporated into the Hungarian Civil Code and is expected to be a new stimulus for the Hungarian economy.2

II TAX

i Personal income tax

Hungarian tax-resident status

The rules applicable to personal income tax (PIT) are set out in the Act of CXVII of 1995 on Personal Income Tax (the Act on PIT). According to Section 3 of the Act on PIT, the following should be regarded as being resident for PIT purposes in Hungary:

a Hungarian citizens;
b European Economic Area (EEA) nationals who spend at least 183 days per calendar year (including the day of entry and the day of exit) in Hungary; and
c third-country nationals who have a permanent residence permit or stateless status in Hungary.

Also, individuals qualify as being resident in Hungary for PIT purposes if:

a their only permanent home is in Hungary;
b their centre of vital interests is in Hungary if there is no permanent home in Hungary or if Hungary is not the only country where they have a permanent home; or
c their habitual abode is in the domestic territory if there is no permanent home in Hungary, or if Hungary is not the only country where they have a permanent home and if their centre of vital interests is unknown.

1 Janos Pasztor is a senior associate heading the tax practice group at Wolf Theiss Budapest.
For the purpose of a permanent home, any form of home may be taken into account (e.g., a house or apartment belonging to or rented by the individual, or a rented furnished room). However, the permanence of the home is essential; this means that the individual has arranged to have a dwelling available to him or her at all times continuously, and not occasionally for the purpose of a stay that, owing to the reasons for it, is necessarily of a short duration (e.g., business travel, educational travel). To substantiate that the individual has a permanent home in Hungary, it is usually required to have at least a rented flat for which he or she is paying utility, telephone and internet bills.

As regards the notion of centre of vital interest, the Hungarian tax authority largely follows the Organisation for Economic Co-operation and Development (OECD) Commentary and claims that the centre of vital interest is the country with which the personal and economic relations of the individual are closer. Thus, his or her family and social relations, occupation, political, cultural and other activities, place of business, and the place from which he or she administrates his or her properties should be considered. The circumstances must be examined as a whole, but considerations based on the personal circumstances of the individual (e.g., close family relatives living in the same household) must receive special attention.

Hungarian tax residents are subject to income tax on worldwide income, regardless of whether the funds are transferred to Hungary. Non-residents are taxed on income from Hungarian sources only.

**Hungarian PIT treatment of interest, dividend income and capital gains**

We summarise the Hungarian PIT treatment of certain passive income earned by Hungarian tax residents below.

**Interest**

Hungarian-resident individuals are subject to PIT on their worldwide income, including interest income.

It may occur that the source country of the interest income imposes a withholding tax on the same income. To eliminate double taxation, the Hungarian domestic legislation grants credit for the taxes paid abroad. The maximum amount of the tax credit would be subject to certain limitations. If there is a double tax treaty in force between the two countries concerned, the relevant double tax treaty rules will apply to eliminate double taxation.3

Interest income of a Hungarian-resident private individual will be subject to Hungarian PIT at a rate of 15 per cent in 2018.

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3 Hungary has several double tax treaties (DTTs) with countries that include the Balkans, Belarus, Brazil, Canada, the countries of the Caucasus, the European Union, Iceland, Kazakhstan, Liechtenstein, Mexico, Moldova, Norway, Russia, San Marino, Switzerland, Ukraine, the United States, Uruguay and Uzbekistan. There are DTTs in place with Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, Mongolia, Pakistan, the Philippines, Singapore, South Korea, Taiwan, Thailand and Vietnam. Hungary also has DTTs with African countries, namely Egypt, Morocco, South Africa and Tunisia. In recent years, Hungary ratified DTTs with more countries of the Middle East, i.e., Bahrain, Iran, Israel, Kuwait, Oman, Qatar, Saudi Arabia, Turkey and the United Arab Emirates. Additionally, Hungary has ratified tax information exchange agreements with Jersey and Guernsey.
The Act on PIT applies a broad definition of interest income; in connection with publicly offered and traded debt securities and collective investments in transferable securities, interest shall mean the following:

a. income paid to the private individual under the title of interest or yield, if the securities are held at a specific time prescribed as a precondition for entitlement to interest or yield; and

b. in certain cases, the capital gains achieved when securities are called, redeemed or transferred. In connection with collective investments in transferable securities, redemption shall also cover when the securities are exchanged upon the transformation or merger of the investment fund for the investment certificates of the successor fund. Gains from the transfer of collective investments in transferable securities in certain qualified exchange markets or in a market of an EU, EEA or OECD state will not qualify as interest income, but will be considered as income from capital gains for Hungarian tax law purposes.

In the event that the interest income is paid in the form of valuable assets (e.g., securities) and the Hungarian paying agent cannot withhold the relevant tax, the taxable base would be assessed in the amount of the fair market value of the asset received multiplied by 1.18.

If the interest income is received from a Hungarian paying agent, such paying agent should withhold the PIT. If the interest income is not received from a paying agent, taxes should be assessed, declared and paid to the tax authority by the private individual himself or herself in his or her regular annual tax return.

Payments distributed by or on behalf of a legal person or other organisation having its seat in a low tax jurisdiction\(^4\) are subject to PIT at a 15 per cent rate and the recipient should pay health tax of 19.5 per cent, in addition to the PIT. Note, however, that the legislation does not provide for any adverse tax implications in respect of interest received from controlled foreign companies\(^5\) (CFC) because the definition of the low-tax jurisdiction does not cover CFCs.

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\(^4\) Low-tax jurisdiction means a state that refrains from imposing CIT or if the tax rate thereof is 9 per cent or lower, unless Hungary has concluded a Double Tax Convention with such state.

\(^5\) Under Hungarian tax legislation, CFCs are foreign persons not qualifying as foreign entrepreneurs or Hungarian-resident taxpayers, in which the taxpayer (either on its own, or with its related parties) – directly or indirectly – holds more than 50 per cent interest (shareholdings or voting rights) or is entitled to a share of after-tax profit exceeding 50 per cent thereof in the financial year, in which the tax equivalent to the CIT paid by the foreign legal entity is less than the difference with which the CIT that it would have paid assuming that its seat were in Hungary exceeds the tax equivalent to the CIT paid by the foreign legal entity (i.e., CIT paid by the foreign person is less than 50 per cent of the Hungarian CIT that the foreign entity should have paid in Hungary if it were a Hungarian taxpayer). The Hungarian tax legislation also regards foreign permanent establishments of a Hungarian resident taxpayer to be a CFC if in the tax year, in which the tax paid by the foreign permanent establishment is less than the difference with which – assuming that the permanent establishment was located in Hungary – the CIT that it would have paid exceeds the tax equivalent to the CIT paid by the foreign permanent establishment. The foreign legal entity or the foreign permanent establishment should not be considered as a CFC if it carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.
Dividend
The dividend income of a Hungarian resident private individual is subject to PIT at a rate of 15 per cent and health tax at the rate of 14 per cent in 2018 (the latter is capped at 450,000 forints per annum).

Dividend payments distributed by or on behalf of a legal person or other organisation having its seat in a low tax jurisdiction are subject to PIT at a 15 per cent rate and the recipient should pay health tax of 19.5 per cent in addition to PIT.

Capital gains
Capital gains realised by a Hungarian-resident private individual will be subject to PIT at a rate of 15 per cent and health tax at a rate of 14 per cent in 2018 (the latter is capped at 450,000 forints per annum).

Capital gains arising from the sale of shares in a legal person or other organisation having its seat in a low-tax jurisdiction would be subject to PIT at 15 per cent and health tax at 19.5 per cent.6

Under certain conditions, preferential PIT rules may apply to income from the ‘controlled capital market transactions’ of private individuals.

Income from ‘controlled capital market transactions’ shall be calculated as the difference between the total profit and the total loss realised on transactions during the tax year. In 2018, a 15 per cent PIT rate would apply on that income. Because of the preferential tax treatment of ‘controlled capital market transactions’, the private individual could be entitled to tax compensation with respect to losses realised from controlled capital market transactions during the tax year, during the year preceding the current tax year and in the two years preceding the current tax year. Tax ‘calculated’ for such losses could reduce the taxes calculated on gains realised by the private individual from controlled capital market transactions during the tax year, during the year preceding the current tax year and in the two years preceding the current tax year.

Furthermore, in cases of transfer of shares in a Hungarian real estate holding company as defined by the Act LXXXI of 1996 on the Corporate Income Tax and Dividend Tax, a charge to Hungarian PIT (15 per cent) arises at the foreign shareholder in respect of any income triggered on the transfer of shares in a real estate holding company unless the applicable double tax convention excludes the taxation of such capital gains in Hungary.7

Income from qualified long-term investments
Preferential tax rules may apply to income from ‘qualified long-term investments’ of private individuals.

Income derived from qualified long-term investments refers to the profit the private individual realises under a long-term investment contract entered into with an investment

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6 Based on a current legislative proposal by the Hungarian government, health tax on interest, dividend and capital gains income would be replaced by the social tax setting out a uniform tax rate of 19.5 per cent from 1 July 2019. According to the proposal, the tax base to which this rate would apply would be capped at the minimum wage multiplied by 24 (i.e., 3,312 million forints calculated based on the minimum wage currently in effect).

7 As of 1 January 2018, a new Double Tax Convention entered into force between Luxembourg and Hungary, which allows for Hungary to tax the capital gain arising at a Luxembourg resident individual or entity upon the alienation of shares in a Hungarian real estate holding company.
service provider or a credit institution. Under the long-term investment contract, the private individual places an amount equal to at least 25,000 forints on his or her account for a minimum period of three (and further two) years, and the parties agree on applying the preferential taxation rules laid down by the Act on PIT. If all the conditions prescribed by law are fulfilled and the ‘qualified long-term investment’ is held for less than three years, for the 2018 tax year a 15 per cent rate may apply, while if the investment lasts at least three years, a preferential 10 per cent rate is applicable; income from qualified long-term investments would be subject to a zero per cent rate if the investment is held for at least five years. Under certain conditions, the above beneficiary tax rules may also extend to foreign qualified long-term investments, where the investment service provider or the credit institution is not subject to Hungarian data disclosure requirements.

ii Inheritance tax and gift tax

The inheritance of assets located in Hungary would be subject to Hungarian inheritance tax regardless of the nationality of the heirs. If the inheritance is handed over during a probate action then the tax authority assesses the inheritance tax and informs the heirs regarding the tax payable.

The base of the inheritance tax and the gift tax is the net value of the inheritance or gift, which is the market value of properties inherited or gifted less any liabilities related to the inheritance or gift.

The generally applicable inheritance and gift tax rate is 18 per cent. However, a preferential 9 per cent tax rate applies to residential properties. In the case of vehicles, the inheritance and gift tax are double the transfer tax. Special rules apply in cases of inheritance of beneficiary ownership over real estate properties or rights with pecuniary value.

Hungarian legislation provides for exemption from inheritance and gift tax in several cases, such as the following:

a succession and gift by and to lineal relatives or a spouse is exempt from inheritance and gift tax;
b if the heir is a stepchild, step-parent, foster child or foster parent of the deceased, 20 million forints from the tax base qualifies as a tax-exempt inheritance;
c the inheritance and gifting of debt securities issued by an EEA Member State;
d inheritance that has been granted for scientific, artistic or educational purposes; and
e if the heir or recipient undertakes to build a residential property within four years after the succession or gifting and the total territory of the flats in this residential property is at least 10 per cent of the maximum build-in territory, the inheritance or gifting of the land would be exempt from inheritance or gift tax. To become eligible for this exemption, the heir or recipient should file a statement to the tax authority. The tax authority will assess after four years whether the heir or recipient has fulfilled all obligations related to the tax exemption. In the case of non-compliance, the heir or recipient should pay inheritance or gift tax, plus the amount of the late payment interest.

8 Act XCIII of 1990 on Duties.
If the heir offers any fine art, applied art or folk art creation, or museum piece, collection or a part of it that he or she has inherited to the Hungarian state, municipality or higher education institution and it has been accepted by the recipient, then the inheritance or the offered part of the inheritance is exempt from inheritance tax.

In cases of underage heirs, the inheritance tax may be payable without any late payment interest until the end of the second calendar year from the date they have reached maturity. If the underage heirs pay their inheritance tax liability in advance then the amount of tax should be decreased by 10 per cent to 70 per cent.

In the case of the inheritance of the ownership of arable land or rights with pecuniary value relating to the arable land, the applicable tax rate is half (and in certain cases a quarter) of the general tax rate.

### iii Transfer tax

Transfer tax is payable upon the acquisition of real estate property, movable property on auctions, cars and trailers, rights of pecuniary value (e.g., rights related to real estate, cars), usufruct on real estates, building structures in public places and acquisition of securities by means of contract of inheritance.

Since 2010, the acquisition of shares in a real estate holding company is also subject to real estate transfer tax (RETT), provided that the ownership of the acquirer reaches 75 per cent of the company that holds the real estate in Hungary. Under transfer tax legislation, an entity should be regarded as a real estate holding company if the value of the real estate in Hungary owned by that entity exceeds 75 per cent of the total value of the assets (excluding liquid assets, monetary claims, accruals and loans) of the entity shown on the balance sheet that was most recently formally approved. An entity should also be regarded as a real estate holding entity if it holds directly or indirectly at least 75 per cent of shares in a company that fulfils the above conditions.

The standard rate of RETT is 4 per cent of the market value of the acquired real estate. If the market value of a real estate property exceeds 1 billion forints, the rate of the RETT on the exceeding part is 2 per cent, but the RETT liability is capped at 200 million forints per real estate property.

### iv Property taxes

**Building tax**

Local municipalities may levy tax on buildings. The maximum of the building tax is either 1,100 forints per square metre (adjusted with cumulated inflation) or 3.6 per cent of the adjusted fair market value of building.

**Land tax**

Land tax may be levied by local municipalities on the owner of the land. The land tax is either charged annually based on the area of land owned, at a maximum rate of 200 forints per square metre (adjusted with cumulated inflation) or based on the adjusted fair market value of the land, at a maximum of 3 per cent.

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9 Act XCIII of 1990 on Duties.
Hungary

III SUCCESSION

i Hungarian succession rules

The respective rules of Hungarian succession law are set out in the Civil Code.\(^{10}\)

The main rule of Hungarian succession law is that the heirs acquire the inheritance by the mere fact of the death of the deceased person.\(^{11}\) Accordingly, the heirs become the owner of the properties at the time of death; however, they are not entitled to exercise their rights relating to the inheritance (e.g., to register their ownership in the land registry) until the notary public has rendered a binding resolution on the handover of the heritage during the probate action. Therefore, the aim of the probate action is to identify the properties of the deceased person and to clarify the inheritance relationships and make a resolution regarding the succession. In the event of any dispute concerning the resolution of the notary public, each of the interested persons could challenge the resolution before the court.

Under Hungarian law, the inheritance takes place either according to a disposition of property upon death or in accordance with the statutory rules.\(^{12}\) If there is a disposition of property upon death at hand it must prevail over the statutory regime.\(^{13}\) A disposition of property upon death could cover either the entire heritage or some part of the estate of the deceased person.\(^{14}\) If the disposition of property upon death does not cover the entire heritage, the statutory regime of inheritance applies in respect of the remaining parts.\(^{15}\)

Inheritance by disposition of property upon death

In the case of the disposition of property upon death, the Civil Code provides for the formal requirements and the eligible terms of such dispositions. The Civil Code distinguishes between last will, contract of succession and donation upon death.

Besides the public will that is made in the presence of a notary, the Civil Code recognises private wills (including the holographic will and other forms of last wills made in writing) and oral wills.\(^{16}\) An oral will is valid only if a danger threatening the testator with death hinders him or her in making a last will in writing and if two witnesses are present.\(^{17}\) The Civil Code introduced a new feature to Hungarian succession law, namely the joint will. Under Hungarian law, only spouses may make a joint will.\(^{18}\)

In the framework of a contract of succession, the testator makes a disposition of property upon death in favour of the other contracting party, while this other party is obliged to provide either maintenance or periodic payment of any other sum or services of care to the testator.\(^{19}\)

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\(^{10}\) Act V of 2013 of the Civil Code.

\(^{11}\) Sections 7:1 and 7:87 of the Civil Code.

\(^{12}\) Section 7:3(1) of the Civil Code.

\(^{13}\) Section 7:3(2) of the Civil Code.

\(^{14}\) Section 7:10 of the Civil Code.

\(^{15}\) Section 7:30 of the Civil Code.

\(^{16}\) Sections 7:13 to 7:17 and 7:20 of the Civil Code.

\(^{17}\) Sections 7:20 and 7:21 of the Civil Code.

\(^{18}\) Section 7:23 of the Civil Code.

\(^{19}\) Section 7:48(1) of the Civil Code.
The rules on reserved share represent, however, a significant limitation to the autonomy of the testator. The descendants, the spouse or the registered partner and the parents of the deceased can claim their reserved share if they inherit in the absence of any disposition of property upon death.  

**Inheritance by law**

Under the statutory regime of succession, the estate of the deceased must be distributed among his or her relatives and spouse or registered partner in accordance with the strict order of succession set out in the Civil Code. Children and their descendants constitute the first category, followed by the parents and their descendants. Then comes the category of grandparents and their descendants, which is followed by the category of great-grandparents and their descendants, and finally the ancestors of the great-grandparents. However, the category of grandparents and their descendants may inherit only if the spouse or the registered partner could not be the heir of the deceased. Relatives within a category inherit in equal shares.

Prior to the new rules of the Civil Code, the spouse or the registered partner was only able to inherit usufruct over the estate of the deceased. Under the new rules, if at least a child or a descendant of a child is an heir, both the spouse or the registered partner inherit usufruct over the residential property and its equipment used together with the deceased and a share of the rest of the inheritance corresponding with the share of a child. If there is neither child nor a descendant of a child, the spouse or the registered partner inherits the residential property and its equipment that was used together with the deceased, and half of the rest of the inheritance, while the parents of the deceased inherit the other half of the rest of the inheritance. If there is neither child nor descendant of a child nor parent, the spouse or the registered partner inherits the entire estate.

If the heir is not a descendant of the deceased, there is a special regime of succession with respect to the assets the deceased inherited or received as a gift either directly or indirectly (through his or her brother or sister or any of the descendants of the aforementioned). In this case, only those persons who provided the asset to the deceased or whose ancestor provided the asset to the deceased can inherit. The spouse or the registered partner has usufruct over the respective assets in this case. If no one can inherit the assets under this regime, the general rules of inheritance by law apply.

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20 Section 7:75 of the Civil Code.
21 Sections 7:55(1) and (3), 7:63(1) and (2) of the Civil Code.
22 Sections 7:64(1) and (2), 7:65(1) and (2) and 7:66 of the Civil Code.
23 Section 7:64(1) of the Civil Code.
24 Sections 7:55(2), 7:63(1), 7:64(1), 7:65(1) and 7:66 of the Civil Code.
25 Section 7:58(1) of the Civil Code.
26 Section 7:60 of the Civil Code.
27 Section 7:61 of the Civil Code.
28 Section 7:67(1) and (2) of the Civil Code.
29 Section 7:69(1) of the Civil Code.
30 Section 7:68(3) of the Civil Code.
Matrimonial issues

The respective Hungarian rules of matrimonial property are set out in the Civil Code. The basic rule is that unless the spouses conclude a matrimonial property agreement, the rules of the statutory matrimonial property regime prevail.\textsuperscript{31}

The statutory matrimonial property regime

The rules of the statutory matrimonial property regime apply only during the life of the spouses as a couple in the same household once they have concluded a marriage.\textsuperscript{32} These rules no longer apply if: the spouses conclude a matrimonial property agreement; the court terminates the matrimonial common property during the spouses’ life as a couple; or the spouses no longer live together.\textsuperscript{33}

Under the statutory matrimonial property regime, the assets the spouses had before their marriage belong to their own separate estates.\textsuperscript{34} Additionally, \textit{inter alia}, the assets inherited or received as a gift, IP rights and the surrogate of the assets belonging to the separate estate constitute the parts of the spouses’ separate estates.\textsuperscript{35} The assets acquired during the spouses’ life as a couple constitutes common property.\textsuperscript{36} Both of the spouses may use the common property and manage and administer these assets together.\textsuperscript{37} This rule has limited application in respect to shares, shareholdings and the assets necessary for the business or other profession of one of the spouses.\textsuperscript{38} Under this regime, each spouse is liable to third parties for the performance and the breach of any contracts concerning any common property limited to their shares in the common property.\textsuperscript{39}

Matrimonial property agreements

The Civil Code contains two types of model rules in respect of matrimonial property agreements. This means that unless a mandatory rule prohibits the derogation from these rules, the parties could agree otherwise.\textsuperscript{40} The spouses could limit their liability with respect to their common property towards third parties under the matrimonial property agreement if they register the agreement in the appropriate registry.\textsuperscript{41}

Under one model regime, both of the spouses have their own separate estates and each of them is entitled to half of the assets acquired during their life as a couple.\textsuperscript{42} Under the other model regime, both of the spouses have their own separate estates and they have to bear only the costs of the common household and the education of the children together.\textsuperscript{43} Deviation from the obligation to bear these costs is not allowed.\textsuperscript{44}

\begin{itemize}
\item \textsuperscript{31} Section 4:34(2) of the Civil Code.
\item \textsuperscript{32} Section 4:35(1) of the Civil Code.
\item \textsuperscript{33} Section 4:53 of the Civil Code.
\item \textsuperscript{34} Section 4:38(1)(a) of the Civil Code.
\item \textsuperscript{35} Sections 4:38(1)(b), (c) and (f) of the Civil Code.
\item \textsuperscript{36} Section 4:37(1)(a) of the Civil Code.
\item \textsuperscript{37} Sections 4:42(1) and (2) of the Civil Code.
\item \textsuperscript{38} Section 4:43 of the Civil Code.
\item \textsuperscript{39} Section 4:49 of the Civil Code.
\item \textsuperscript{40} Section 4:63(2) of the Civil Code.
\item \textsuperscript{41} Section 4:65(2) of the Civil Code.
\item \textsuperscript{42} Sections 4:69 to 4:71(2) of the Civil Code.
\item \textsuperscript{43} Sections 4:72 to 4:73(2) of the Civil Code.
\item \textsuperscript{44} Section 4:73(2) of the Civil Code.
\end{itemize}
**Partners and registered partners**

The assets of partners living together outside marriage remain their own separate estates, and upon the end of their relationship as a couple, each of them can claim a part of the assets acquired during their life as a couple corresponding to the respective partner’s contribution in the acquisition of those assets. The partners can deviate from these rules by an agreement.

Although same-sex marriage is not available in Hungary, same-sex couples may register their relationship as set out in the Registered Partnership Act. The rules of succession and matrimonial property applicable in respect to marriage and spouses also apply to the registered partnership and registered partners.

**IV WEALTH STRUCTURING AND REGULATION**

**i Hungarian trusts**

The Civil Code provides for new rules for Hungarian trusts and private foundations, although the latter seems to be less suitable for wealth structuring.

Nevertheless, the introduction of the new Hungarian rules on trusts represents dramatic improvements in wealth structuring. While the Civil Code contains the rules on the relationship between the settlor, the trustee and the beneficiary, the Trustees Act provides for the regulatory framework for providing such services.

**The relationship between the settlor, the trustee and the beneficiary**

The Civil Code sets out the rules on trusts within the rules of contract law. The Civil Code provides that the parties are free to deviate from the rules of contract law regarding their rights and obligations, unless the statute does not allow any derogation. Hence, the statutory rules of trust as set out in the Civil Code are mostly model rules. There are five trust-specific mandatory rules where a derogation is not allowed:

- the trust arrangement needs to be in writing;
- the trustee should not be the sole beneficiary;
- the trust assets need to be separated from the trustee’s own assets and other trust assets;
- neither the settlor nor the beneficiary may give instructions to the trustee; and
- the term of the trust arrangement may not exceed 50 years.

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45 Section 6:516 of the Civil Code.
46 Section 6:515 of the Civil Code.
47 Act XXIX of 2009 on the Registered Partnership.
48 Section 3(1) of the Registered Partnership Act.
51 Section 6:59 (2) of the Civil Code.
52 A Menyhei, ‘Development of the estate planning industry through the introduction of the trust in Hungary’ (2016) 22 Trusts & Trustees 659, 662.
A trust arrangement could be established either by a contract between the settlor and the trustee or by a unilateral declaration of the settlor or by a testament. 54

In the framework of the trust under Hungarian law, the settlor transfers the title of the property or assigns rights and claims to the trustee. The trustee is obliged to manage the transferred trust assets in his or her own name and for the benefit of the beneficiary, while the settlor shall pay a fee for the trust management to the trustee. 55 The beneficiary may claim the distribution of the trust assets and their profits in accordance with the trust deed. 56

Under the trust arrangement, the trustee is obliged to act for the utmost benefit of the beneficiary’s interests in accordance with the fiduciary nature of the trust. 57 The trustee is liable for the trust assets as well as the performance of the obligations incurred. 58 The trustee could dispose over the trust assets in accordance with the terms specified in the trust deed. 59 The trustee has the right to remuneration and reimbursement in respect to the expenditures out of the trust assets. 60

One of the major issues of trusts is the position of the creditors. The creditors of the trustee may not enforce any claim against the trust assets and the trust assets do not belong to the inheritance of the trustee. 61 The creditors of the beneficiary may enforce claims on the trust assets only if the trustee’s obligation to transfer the trust assets to the beneficiary is due. 62 The creditors of the settlor can pursue claims against the trust assets only if the settlor aimed at avoiding payment of the debts in question by setting up the trust. 63

Moreover, tracing is one of the most significant issues that the law needs to address with regard to trusts. Under Hungarian law, if the trustee was in breach of the trust deed by alienating or encumbering the trust assets, the settlor and the beneficiary could claim from third parties, who were not in good faith or acquired the assets free of charge, the transfer of the assets back to the trust assets. 64 The trust terminates if:

\[
a \quad \text{the trust assets cease to exist;}
\]
\[
b \quad \text{the trustee gives notice;}
\]
\[
c \quad \text{there is no trustee with respect to the trust assets for a period exceeding three months;}
\]
\[
d \quad \text{the settlor is the sole beneficiary in the event that the settlor dies;}
\]
\[
e \quad \text{the settlor gives notice with regard to a contract entered into for an indefinite period; or}
\]
\[
f \quad 50 \text{ years have passed since the establishment of the trust.} 65
\]
It is not sufficient grounds to terminate the trust if the settlor becomes the legal successor of the trustee.\textsuperscript{66} In the event that any of the settlors, the trustee or the beneficiary dies or ceases to exist, the trust would still continue to exist.\textsuperscript{67}

Taking account of the above model rules, it was concluded in the academic literature that the concept of trust under Hungarian law corresponds with the definition of trust as defined in the Hague Convention on the Law Applicable to Trusts and Their Recognition.\textsuperscript{68}

\textbf{Regulatory framework of trusts}

The Trustees Act provides specifically for licensing, notification and registration requirements.

To manage two or more trusts as a trustee, i.e., on a business scale, a licence from the National Bank of Hungary (MNB) is necessary.\textsuperscript{69} Such a licensed trustee could be a limited liability company, a joint stock company or the branch of an EEA undertaking. The licensed trustee needs to meet certain transparency criteria and must have registered capital of at least 70 million forints.\textsuperscript{70} Additionally, the licensed trustee must have financial collateral of a value corresponding to at least 20 per cent of the trust assets, but ranging from 70 million to 1.5 billion forints.\textsuperscript{71} The legislation also prescribes conditions with respect to the managing directors of the trustee.

In the event that the trustee accepts the appointment on an \textit{ad hoc} basis and not on a business scale, the trustee is merely required to notify the MNB.\textsuperscript{72}

\textbf{Taxation of trusts}

As a general rule, the transfer of the assets between the settlor and the trustee is tax-neutral as it does not trigger any tax liability in Hungary:\textsuperscript{73} any properties (e.g., real estate, shares in a company) can be transferred into the trust without incurring any tax obligations, which may arise only when the assets and their yields are allotted to the beneficiaries.\textsuperscript{74}

For corporate income tax purposes, the trust assets (managed assets) are considered a corporate income taxpayer.\textsuperscript{75} This means that any tax benefits granted to Hungarian tax-resident entities are also available for trust assets. Therefore, trusts can be used for various domestic and international tax planning purposes (e.g., making use of favourable rules of holding regimes, tax-neutral company restructurings, asset transfers, eliminating related party classifications).

In cases of distribution, the managed assets must be categorised as capital and yield. If the trustee distributes the capital to a beneficiary, a gift tax liability may arise, unless the

\begin{itemize}
\item \textsuperscript{66} Section 6:326(4) of the Civil Code.
\item \textsuperscript{67} Section 6:326(5) of the Civil Code.
\item \textsuperscript{68} The Hague Convention on the Law Applicable to Trusts and on Their Recognition (1985); A Menyhei, "Development of the estate planning industry through the introduction of the trust in Hungary" (2016) 22 Trusts & Trustees 659, 661.
\item \textsuperscript{69} Section 3(1) of the Trustees Act.
\item \textsuperscript{70} Sections 3(1) and 7(2) of the Trustees Act.
\item \textsuperscript{71} Section 2(1) of the Decree of the Government No. 87 of 20 March 2014 on Certain Rules on the Financial Collaterals of Trustee Undertakings.
\item \textsuperscript{72} Section 19 of the Trustees Act.
\item \textsuperscript{73} Section 17/D of the Act XCIII of 1990 on Stamp Duties; A Menyhei, 'Estate Planning in Hungary: Private Foundation or Trust?' (2015) 21 Trusts & Trustees 650, 651.
\item \textsuperscript{74} Section 17/D(2) of the Act XCIII of 1990 on Stamp Duties.
\item \textsuperscript{75} Section 2(6) of the Act LXXVI of 1996 on Corporate Tax and Dividend Tax.
\end{itemize}
beneficiary is the settlor or the spouse or a lineal relative of the settlor. If the yield of assets is distributed to the beneficiary, the beneficiary is obliged to pay PIT in accordance with the rules applicable to dividends.⁷⁶

**Fields of use**

Besides tax planning opportunities, trusts may be used for several purposes, such as:

- maintaining and preserving family businesses combined with professional asset management expertise to be able to continue the family business successfully;
- deviating from statutory inheritance rules as an alternative and more flexible solution to testaments (e.g., for avoiding collisions in case of cross-border scenarios);
- protecting the estate against potential future creditors;
- providing representation for the beneficiaries;
- establishing joint ventures and performing share acquisitions for collateral purposes; and
- safeguarding business secrets.

**V OUTLOOK AND CONCLUSIONS**

Based on the above developments, it is clear that Hungary has made a great leap towards being an attractive location for high net worth individuals. The new Hungarian trust represents a significant improvement in terms of private wealth management and for the private wealth industry in Hungary, and could be a stimulus for the Hungarian economy.

Besides domestic legislative changes, Hungary is very much exposed to international trends, such as OECD Base Erosion and Profit Shifting, the automatic exchange of information and EU anti-avoidance. In 2014, Hungary ratified the Convention on Mutual Administrative Assistance in Tax Matters along with the Protocol amending the Convention.⁷⁷ Furthermore, in 2015, Hungary became a party to the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Accounts Information,⁷⁸ implemented the DAC2 Directive⁷⁹ and the 4th AML Directive.⁸⁰ Hungary is also among the signatories to the

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⁷⁸ Act CXC of 2015 on the Promulgation of the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Accounts Information. Hungary will exchange financial account information (such as data identifying the beneficiary owner, data on the assets and revenues, etc.) with the following countries: Andorra, Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, Chile, China, Colombia, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Guernsey, Iceland, India, Indonesia, Ireland, Isle of Man, Italy, Japan, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malaysia, Malta, Mauritius, Mexico, Monaco, the Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Romania, Russia, San Marino, Saudi Arabia, Seychelles, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland and the United Kingdom. Exchanges have taken place since September 2017 (except for some countries, e.g., Australia, Brazil, Canada and Japan, which intend to exchange information by September 2018).
Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) and is committed to implementing the MLI minimum standards into its bilateral tax treaties. In addition, in compliance with the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (ATAD), Hungary has already modified its regulation regarding CFCs and it aims to transpose the other anti-avoidance measures of ATAD in 2018.
I INTRODUCTION

The Isle of Man is an independent, self-governing British Crown dependency located in the Irish Sea, approximately equidistant between Great Britain and Ireland. According to the most recent census, a population of approximately 85,000 inhabits the 227-square-mile land mass, which measures 33 miles north to south and 13 miles east to west at its extremities.

The island’s population is divided almost equally between those born and raised locally, and those that have relocated there. Its population enjoys a high standard of living, with average earnings in 2018 of approximately £39,500 per annum (47 per cent higher than in the United Kingdom), and until 2017 had enjoyed continuous economic growth for more than 30 consecutive years. Unemployment is very low, at less than 1 per cent, and a work permit system is in operation for non-Manx workers to control the number of foreign workers. Consultation is currently underway regarding a potential loosening of the work permit requirements in recognition of the low unemployment and need for additional skilled workers.

As a Crown dependency, the Isle of Man is part of the British Commonwealth, with Her Majesty Queen Elizabeth II as head of state (Lord of Mann); she is represented on the island by the Lieutenant Governor, who is appointed by the Crown for a five-year term.

The island’s immigration rules are substantially the same as those of the UK, and the Isle of Man government actively encourages immigration to the island that would bring a positive contribution to economic growth. Commonwealth and European Union citizens have an automatic right to residency, and there are no restrictions on ownership of local property, so that anyone moving to the island can purchase property immediately. A number of high net worth individuals have made their home on the Isle of Man, many of them in conjunction with the relocation or establishment of their business interests; however, there is also a good cross-section of social strata with an inevitable bias towards working professionals owing to the significant size of the finance industry.

i Political system

As noted previously, the island is self-governing, with its parliament, Tynwald, being the oldest continuous parliament in the world. Tynwald consists of a lower house, the House of Keys, containing 24 members of the House of Keys (MHKs) elected by popular vote, and an upper house, the Legislative Council, whose members are voted in by the MHKs. Historically, members of the Legislative Council would have served as MHKs before their

Craig Brown is the managing director of First Names Group in the Isle of Man.
election; however, this practice has now changed significantly with a view to electing a Legislative Council with a wide range of experience. Party politics are almost non-existent, and MHKs are elected based on personal manifestos as opposed to party affiliations. As a result, government policy tends to be more stable, rather than suffering from the polar swings sometimes experienced by countries that are dominated by a two-party system.

**ii Legal framework**

The Isle of Man is a common law jurisdiction, based very closely on English law, with legislation being passed by Tynwald. Acts of Parliament can be extended to the Isle of Man with the express consent of Tynwald; however, this happens rarely in practice. The legislative system is extremely stable and judges in the High Court of Justice are known locally as Deemsters, the most senior of which is the First Deemster. English case law is deemed to have persuasive authority in the Isle of Man, and the ultimate appellate court is the Judicial Committee of the Privy Council.

Given the island’s thriving economy, close ties to the UK and Europe, stable political system, robust legal and regulatory framework and well-established finance industry, the Isle of Man serves as a significant jurisdiction for private client matters, such as wealth structuring and succession planning.

**II TAX**

This section is not intended to provide a comprehensive overview of the Isle of Man’s tax rates and practices, but instead to provide a high-level summary as context for the wealth structuring and succession planning considerations being discussed.

**i Personal taxation for individuals**

Manx-resident individuals are subject to taxation on their worldwide income at rates of up to a maximum of 20 per cent, with generous personal allowances on which no tax is paid. Couples may elect for joint taxation, which results in a doubling of tax allowances and income bands above which the 20 per cent rate of taxation applies.

Non-residents with income from a Manx source are liable to tax at 20 per cent on the income, with no personal allowance.

It is possible for a Manx resident to elect to cap their total income tax liability at £125,000 per annum for a five-year period. This figure is doubled for couples who have elected for the joint basis of taxation.

**ii Other taxes**

Most companies in the Isle of Man are subject to corporation tax at the rate of zero per cent. There are exceptions for licensed banks and local retail businesses with a taxable profit above £500,000, both of which are taxed at a rate of 10 per cent, and for income derived from Isle of Man land and property, which is taxed at 20 per cent.

Value added tax (VAT), currently at the rate of 20 per cent, applies to the supply of most goods and services in the Isle of Man through a system that is substantially the same as that in the United Kingdom, albeit that it is administered separately by the Isle of Man’s Customs and Excise Division. The island is treated as part of the United Kingdom and European Union for customs, excise and VAT purposes under its Customs and Excise Agreement with the United Kingdom.
The Isle of Man does not impose taxation on capital gains, nor is there any inheritance tax, wealth tax or stamp duties.

iii Cross-border structuring
The Isle of Man has an extensive network of double taxation agreements and, as a responsible and forward-thinking international financial centre, it is also party to many tax information exchange agreements. There is no withholding tax on payments of interest or dividends from the Isle of Man, and no transfer pricing legislation.

iv Taxation matters for entrepreneurs
The island’s tax system is highly conducive to entrepreneurs, with the absence of taxes such as corporation tax, capital gains tax and stamp duty, which can be a drain on working capital. The favourable regime for entrepreneurs is further aided by the individual tax cap, which means that shareholders may extract profits from their business by means of dividends while still limiting their overall tax liability to just £125,000.

The favourable corporation tax regime makes the Isle of Man a location of choice for international holding structures since it offers tax neutrality without the need for reliance on specific relieving provisions, such as the substantial shareholding exemptions on the receipt of dividends. This tax neutrality, combined with the stability of both corporate and tax legislation, is a significant factor in the use of Isle of Man companies for holdings on the UK’s alternative investment market (AIM), with the Isle of Man being a jurisdiction of choice for incorporation outside the United Kingdom for AIM-listed companies. This is of significant value to entrepreneurs since it provides a ready-made route to market in the event that there is a need for raising capital, or indeed for the ultimate exit from a business through a public offering.

A further benefit to international business operations is the flexibility permitted in cross-border transactions. The absence of transfer pricing legislation and controlled foreign company rules means that, while business structures and interactions must reflect the true economic structure and commercial reality (as is required, for example, under the Organisation for Economic Co-operation and Development (OECD)’s Base Erosion and Profit Shifting framework), it is possible for international businesses to arrange their internal affairs with relative freedom without the need to consider artificial tax constraints, which can be the unintended consequence of such legislation.

III SUCCESSION
As in English law, Manx law has no forced heirship provisions, allowing complete freedom of testamentary disposition.

i Scope of Manx inheritance laws
Assets subject to Manx inheritance laws are the worldwide assets of any Manx-domiciled individual, or the Manx situated immovable assets of a deceased person wherever that person is domiciled. The impact of inheritance laws in countries other than where an individual resides, whether by reason of domicile or situs of assets, is often overlooked during succession planning and can result in unexpected estate taxes, transfers of assets to parties other than those intended to benefit, or lengthy and costly legal proceedings to finalise the administration.
of the estate. Succession planning structures should, therefore, be considered not just as a tax mitigation tool, but as a means of ensuring the transfer of wealth following an individual’s death in accordance with the wishes that they have expressed during their lifetime.

**ii Administration**

The administration of an estate takes different legal forms depending on whether the individual died testate or intestate, although there are very few differences in practice.

In cases where a person dies leaving a valid will, the executor appointed in the will is required to obtain a grant of probate through the Isle of Man courts. Having obtained probate, the executor will be in a position to dispose of the assets in line with the deceased person’s wishes, subject to holding valid probate for any jurisdictions outside the Isle of Man in which there is immovable property.

Where a person dies intestate, or where an executor is unwilling or unable to act, it will be necessary to obtain a grant of letters of administration to deal with the estate. In such circumstances, the administrator of the estate receives his or her powers through the grant itself, which will permit him or her to deal with the deceased’s estate under the laws of intestacy in the absence of a will, or in line with the deceased’s wishes where a will existed but no valid executor was appointed.

**iii Key legislative matters affecting succession**

Although testamentary freedom is provided for within Manx legislation, safeguards exist for dependants who may apply to the Isle of Man Courts under the Inheritance (Provision for Family and Dependants) Act 1982 if the disposition of the estate ‘is not such as to make reasonable financial provision’. In very simple terms, applications under the Act may be made by any spouse, former spouse who remains unmarried, child or person who was being maintained by the deceased prior to their death. Executors of the estate must, therefore, have regard for making appropriate provision for dependants from the estate to avoid potentially costly court proceedings.

**iv Cross-border considerations**

Where the estate of the deceased includes assets outside the Isle of Man, freedom of testamentary disposition will apply automatically only to the movable property of the testator. Disposition of immovable property usually devolves to the laws in the country in which the property is situated, and care must therefore be exercised to ensure that appropriate provision is made for wills in each country in which immovable property is located.

Professional advice will be required in this complex area to avoid conflict between wills in different jurisdictions, or to avoid partial intestacy or even revocation of an Isle of Man will as a result of conflict between poorly drafted documents.

To avoid potential pitfalls or inadvertently becoming subject to forced heirship rules for non-Isle of Man *situs* property, many individuals will undertake succession planning through the establishment of appropriate vehicles, typically in the form of a trust for their heirs and dependants. Such planning can also have the added advantage of ensuring uninterrupted access to the assets, which might not be the case in the event that probate is required for the distribution of a person’s estate, especially from multiple jurisdictions.
Continuity of business operations

Succession planning often concentrates primarily on the transfer of assets and minimisation of taxes, but for entrepreneurs there is the additional consideration of the effect on a business's operations of the death of a majority owner.

While the primary purpose of succession planning structures is usually to ensure disposition of a person’s estate in line with their wishes, and with the minimum erosion of value through estate taxes permitted by law, the impact on active business structures should not be overlooked. There is often an assumption within entrepreneurial families that the family business will automatically pass within the family without interruption. This assumption will frequently be backed up by the careful drafting of wills, but this fails to take account of the practical disruption that can be faced, even where properly drafted and legally enforceable wills exist.

The use of trusts as a means of providing a succession planning structure can therefore offer intangible benefits such as continuity of shareholding and avoidance of dilution of interests in the business by retaining a single shareholder (with multiple beneficial interests), as opposed to potentially increasing the number of shareholders (and correspondingly reducing the influence of each individual shareholder) following the death of a majority stakeholder.

IV WEALTH STRUCTURING AND REGULATION

The Isle of Man has long been considered a centre of excellence for wealth structuring, offering political and legislative stability while at the same time continuing to innovate and evolve in order to remain at the forefront of the wealth structuring market.

i Commonly used vehicles for wealth structuring

Owing to its well-established trust and company legislation, the Isle of Man is a very popular jurisdiction for wealth structuring and succession planning. In addition to companies and partnerships, which are the vehicles of choice for most business ventures, the island has very favourable and well-established legislation governing the establishment of trusts and foundations, the most commonly used wealth management vehicles.

Trusts

Trusts have a long history on the island and are governed by a combination of judicial precedent and statute, most notably the Trustee Act 1961, the Variation of Trusts Act 1961, the Perpetuities and Accumulations Act 1968, the Trust Act 1995 and the Trustee Act 2001. The Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 was ratified by the United Kingdom on behalf of the Isle of Man in 1985, and given effect (with certain modifications and exclusions) by the Recognition of Trusts Act 1988.

ii Trustee responsibilities and duties

The establishment of a trust is given effect by the legal transfer of assets from the settlor of the trust to an individual or corporation (the trustee) to hold those assets on trust for the beneficiaries of the trust, usually combined with the execution of a trust deed or declaration of trust. This creates a fiduciary relationship between the trustee and beneficiaries of the trust, under which the trustee has responsibilities to:
In essence, the duties of the trustee can be distilled into the concept that they are the legal owners of the trust assets and must manage those assets with due care and skill, only distributing those assets in accordance with the terms of the trust. To the extent that a trustee exceeds these powers they lay themselves open to claims from the beneficiaries of the trust.

iii Forms of trust

The most common form of trust for wealth management is a discretionary trust, in which the trustees have absolute discretion (subject to constraints that may be contained within the trust deed) on the application of the trust assets for the benefit of any beneficiaries provided for in the deed. Trustees of a discretionary trust may receive non-binding guidance from the settlor in a ‘letter of wishes’, which may include items such as potential beneficiaries or the manner in which the trust assets are applied for their benefit. It is important to note, however, that in settling the assets the settlor has ceded absolute control to the trustee; hence it is important for the trust deed itself to include any restrictions or limitations that the settlor might wish to impose on the trustee’s actions.

A less common form of trust is the non-discretionary trust, or fixed interest trust. Such trusts will be far more prescriptive and will typically be used as a means of generational planning, where a wealthy individual wishes to pass wealth to the next generations but at a time of his or her choosing rather than automatically on death. The trust deed will often specify a particular action to be undertaken by the trustees, such as the distribution of a proportion of the trust assets to a named beneficiary on the occurrence of a certain event, for example their 25th birthday or on the occasion of their marriage.

Both discretionary and non-discretionary trusts may also incorporate an ‘interest in possession’, granting certain beneficiaries an absolute right to the income of some or all of the trust assets, but separate from the interest in the capital of those assets that may be held for a completely different beneficiary. Such an approach is often used as a means of providing an income for the surviving spouse of a settlor during his or her lifetime, while preserving the capital for the children and grandchildren following their death.

Until recently, Manx trusts had a maximum perpetuity period of 150 years; however, this has now been abolished so that the trust may have an indefinite lifespan. It is still permissible to include a perpetuity period within a trust deed, however, where the settlor wishes the trust to have a finite duration.

Unlike certain countries, there is no register of trusts in the Isle of Man, nor is there a requirement for trust documents to be filed or made available for public access. This is a
recognition of the right to privacy of those with an interest of the trusts, a matter of increasing importance where the knowledge of an individual’s interest in substantial assets might lead to significant personal security risks.

**Foundations**

Since the enactment of the Foundation Act 2011, it has also been possible to use foundations as an alternative to trusts in the Isle of Man. Often seen as a hybrid between a trust and an incorporated company, foundations can be particularly useful for individuals residing in civil law jurisdictions in which the concept of a trust is not readily recognised. While available for use as a wealth management tool, foundations are more commonly used for philanthropic or charitable purposes owing to the fact that a foundation’s rules will often be more prescriptive than a trust deed. An additional factor that lends itself to charitable and philanthropic purposes is that the administration of the foundation’s assets will be undertaken by a council rather than one or more trustees, thus facilitating the involvement of a wider governing body and providing for succession and continuity of administration over prolonged periods.

Where a foundation is similar to a company is in its separate legal identity that allows it to hold assets in its own name, contract with third parties and sue and be sued.

Unlike a company, a foundation does not have shareholders and has no beneficial interest in its assets, which are held for a specified purpose or for the benefit of named beneficiaries.

Foundations exist under their main constitutional document, the Foundation Instrument (commonly known as its ‘charter’). Among other matters, this defines the purpose for which the foundation has been established, or the foundation’s ‘objects’. For the Instrument to be valid, the objects must be certain, reasonable and possible, while not being unlawful, contrary to public policy or immoral. The objects can be for a specified purpose or for the benefit of a person or class of persons, and are permitted, but not required, to be charitable.

The foundation is managed by its council, which is similar to the board of directors of a company. The foundation council may consist of as few as a single member, with no requirement for that member to be located in the Isle of Man, and it is the council’s role to administer the foundation’s property and ensure that its objects are met. The foundation may or may not have an enforcer, who has a position of oversight, much like the protector of a trust. In cases where the foundation has a specified non-charitable purpose, the appointment of an enforcer is mandatory.

Typical benefits of a foundation would include:

- **a** full legal capacity and title, in contrast to the division of legal and equitable capacities within a trust;
- **b** limited liability. As a result of the foundation’s legal identity any liability attaches to the foundation itself, not to the members, as is the case for a trustee;
- **c** indefinite existence. Foundations are not subject to any limitations on the perpetuity period, a feature that was recently extended to Manx trusts; and
- **d** ability for the founder to influence its operation through specific powers within the charter or by being a member of the council.
In addition, foundations offer many of the benefits of a trust, such as providing certainty of succession through the exclusion of forced heirship, privacy and confidentiality in respect of the foundation’s assets and objects (there being no public record of the Foundation Instrument), and the ability to add or remove beneficiaries even after establishment.

v Tax treatment of trusts and foundations
The Isle of Man tax position of a Manx trust is determined not by the trust itself, but by reference to the underlying beneficiaries. Where there are no Isle of Man resident beneficiaries of the trust there is unlikely to be a liability to Isle of Man taxation; however, where there is at least one Isle of Man resident beneficiary the entirety of the trust income is potentially subject to 20 per cent income tax.

The separate legal identity of a foundation means that for Isle of Man taxation purposes it is taxed as if it were a company.

v Ownership and control of trust or foundation assets
As previously noted, while a settlor may retain an interest in any assets contributed to a trust or foundation, control of those assets passes fully to the trustee or foundation council. The following mechanisms for maintaining a degree of control have long existed, but each has potential disadvantages for the unwary.

Highly prescriptive trust deeds or foundation rules
There is significant flexibility in the form of a trust deed or foundation instrument provided it complies with relevant legislation. It is therefore possible to be extremely prescriptive in the operation of the trust or foundation in order to provide a degree of certainty to the settlor or founder. A major disadvantage of this approach is that trusts and foundations may remain in existence over lengthy periods, during which time there may be significant political, economic or familial changes that were unforeseen at the time of drafting. What may have been seen as proper or prudent provisions upon first drafting may be overly restrictive in the future, or may even have an impact that is diametrically opposed to the original intention. While it may be possible to make changes to the provisions of the trust or foundation, this can be a costly process; therefore, it is usually seen as best practice not to be overly prescriptive within the constitutional documents.

Reserved powers
Though not specifically prescribed in Manx law, it is possible to reserve powers to the trustee, settlor, protector or enforcer. Where the settlor wishes to retain control over the trust assets it is therefore possible for him or her to reserve certain powers. This is, however, not without its associated risks, as where reserved powers are extensive there is always the danger that the settlor may be seen not to have relinquished the trust assets, or that the settlor (or party to whom the powers are reserved) is acting as de facto trustee. Reserved powers should therefore be used with caution, albeit that they can be a very useful tool when used appropriately.

Letters of wishes
By far the most commonly used method of a settlor retaining influence over a trust’s assets is through the use of a letter of wishes. A letter of wishes is not binding on the trustees and may be revised as many times as the settlor sees fit, but it can be a useful mechanism for
conveying the settlor’s wishes regarding the operation of the trust without actually fettering their powers. A responsible trustee will use a letter of wishes to gain an understanding of the settlor’s aims for the trust, and any guidance therein will typically be considered to be highly persuasive provided it is not contrary to the trust deed and does not unfairly disadvantage the beneficiaries. It should not be assumed, however, that a trustee will simply follow a letter of wishes without question, as they must consider any wishes expressed in the context of their duty of care to the beneficiaries. In spite of their non-binding nature, letters of wishes can be extremely useful, especially as they can include matters that might be subject to periodic revision (as a family grows, for example) or include guidance for a trustee that a settlor wishes to keep confidential, since there is no right for a beneficiary to see a copy of any letter of wishes.

**Use of protectors**

Another commonly used tool for a settlor to retain a degree of control is through the use of a protector. At its most basic level, the protector can simply be seen as acting in a policing capacity, ensuring that the trust is being administered correctly. In more practical terms, however, the protector can be used to validate certain matters (the making of investments, adding or removing beneficiaries, revising the terms of a trust, for example) or as an ultimate sanction by being given the right to remove and replace the trustee.

**vi Recent developments in wealth and succession structures**

The introduction of foundations from 1 January 2012 automatically improved the ability to retain influence through the ability to sit on the foundation council, where such a structure is appropriate to the aims of the planning. An equivalent structure is becoming increasingly popular for trusts with the use of the private trust company (PTC).

The PTC is becoming an increasingly popular method for the settlor of a trust to influence its management. The PTC is established with the purpose of acting as trustee of the trust, and it is possible for the settlor, or a representative, to participate in its management by acting as a director of the PTC. Since the PTC has no purpose other than acting as trustee, it will typically be owned by a purpose trust, which will itself have the purpose of incorporating, promoting and maintaining the PTC and hence have no beneficiaries of its own. The PTC can also be an extremely useful tool in assisting generational planning by permitting adult children of the settlor of the trust to act as directors. In doing so this provides them with the experience of managing greater wealth than they might otherwise be used to, while still benefiting from the professional expertise and experience of the rest of the PTC’s board, which will usually consist of professional fiduciaries.

**vii Applicable anti-money laundering regime and other key regulations**

The provision of professional trustee services in the Isle of Man is regulated by, and requires licensing from, the Financial Services Authority, which is an independent body tasked with the oversight of the finance sector in the Isle of Man.

The Isle of Man takes its responsibility for Anti Money Laundering and Countering the Financing of Terrorism very seriously, and has extensive rules and regulations in force. It is fully compliant with the requirements of the US Foreign Account Tax Compliance Act, and as an early adopter of the Common Reporting Standard (CRS), it is committed to the automatic exchange of information between competent authorities, with its first exchange of financial account information under CRS completed in September 2017.
As a result of these regulatory controls and the Isle of Man’s cooperative approach to tax transparency, it is on the OECD tax transparency whitelist. The island has also received favourable reports from the Financial Actions Task Force, the International Monetary Fund and the European Union Code of Conduct Group, confirming that it has met its international obligations.

V OUTLOOK AND CONCLUSIONS

In light of the Isle of Man’s early move towards greater tax transparency and encouragement of structuring that reflects substance in the Isle of Man, it is no surprise that it continues to be a jurisdiction of choice for fiduciary services. Concerns around less well-regulated jurisdictions in connection with wealth structuring and tax planning have resulted in a flight to quality towards the Isle of Man and similar jurisdictions such as the Channel Islands.

Further cooperation between the Isle of Man’s government and international bodies to tackle unacceptable tax practices and money laundering activities (in both offshore and onshore jurisdictions) will further enhance the island’s reputation and should be a source of comfort to high net worth individuals who choose to undertake their structuring in the Isle of Man.

Challenges remain, however, in managing the increasing calls for the removal of privacy and confidentiality in the belief that this will reduce secrecy and tax avoidance. The Isle of Man’s government has already implemented robust systems to identify the ultimate beneficial owners of assets located in, or managed from, the Isle of Man, and has effective mechanisms for the disclosure of this information to interested parties such as the tax authorities of other countries. The continued erosion of personal rights to confidentiality, which results from the introduction of public registers of beneficial ownership, places residents of some countries at unacceptable risk (from kidnap, extortion or even state-sponsored seizure) without actually adding anything to the exchange of tax information that is already possible. Indeed, it could be argued that, were the well-regulated jurisdictions to simply accept the public disclosure of beneficial ownership, it would result in less transparency owing to the fact that there would be a move to jurisdictions who not only have no procedures to be able to identify the beneficial owners of companies and assets but actually encourage secrecy. The Isle of Man government’s commitment to responsible international wealth structuring means that it engages in open and transparent dialogue with governments and international bodies such as the OECD, with a view to formulating and implementing policies and practices that tackle unacceptable financial activities.

Uncertainty and an increasing rate of change are major challenges facing any private client in the current economic and political climate. Choosing a stable, reputable and well-regulated jurisdiction for wealth structuring activities is the prudent choice, and in this regard the Isle of Man ranks as one of the leading international financial centres, meriting a place on the shortlist of anyone undertaking wealth structuring activities.
I INTRODUCTION

Italy is home to individuals of considerable wealth. In particular, medium and large businesses in Italy tend to be owned and managed by Italian families who need advice on the structuring of the generational transfer of the business. Furthermore, Italy attracts foreigners that relocate to Italy under the Italian forfait (lump sum) tax regime for individuals moving to Italy (see Section II.iv). Italy also attracts significant investments, including those in Italian real estate, by non-resident private clients, who need advice on the structuring of the acquisition, ownership and disposal of such investments.

II TAX

i Income tax

Residents are subject to income tax on their worldwide income, including capital gains. Non-residents are subject to income only on their Italian-sourced income.

For income tax purposes, an individual is regarded as a resident of Italy if, for most of the tax period (i.e., the calendar year), he or she is registered with the Official Register of Italian residents, has his or her habitual abode in Italy, or has the main seat of his or her business and interests in Italy (similar to the Organisation for Economic Co-operation and Development (OECD) concept of a ‘centre of vital interests’).

The total taxable income of individuals is subject to income tax at progressive rates up to 43 per cent, plus local surcharges that depend on the municipality of residence.

That said, income from financial assets, as well as capital gains upon the sale of such assets, is generally taxed in the hands of individuals at a flat rate of 26 per cent (12.5 per cent on the interest and capital gains on Italian governmental bonds and bonds issued by foreign states providing for exchange of information). This favourable regime does not, however, apply to dividends and capital gains from participations in unlisted companies and partnerships established in blacklisted jurisdictions, which are entirely liable to tax.

Capital gains realised by individuals upon the sale of real estate, either owned for more than five years or inherited, are generally exempt from income tax. Furthermore, Italy does...
not tax capital gains realised by individuals upon the sale of assets other than financial assets and real estate (such as paintings or statues) unless such gains are realised in the context of a business or of a professional activity (or speculative transaction).

Resident individuals are subject to reporting obligations on foreign-held assets. Since 2013, these obligations also apply to foreign-held assets held by companies, partnerships, trusts, foundations and other entities to the extent that the resident individual qualifies as the beneficial owner for Italian anti-money laundering purposes. The broadening of the definition of beneficial owner, which follows the implementation of the EU Directive 2015/849 of 20 May 2015, has triggered the broadening of the scope of these reporting obligations. Failure to comply with these reporting obligations may result in very severe penalties.

Controlled foreign corporation (CFC) rules may apply to companies, partnerships or other entities established in jurisdictions (other than EU Member States and European Economic Area (EEA) Member States providing for exchange of information) where the nominal tax rate is lower than 50 per cent of the Italian nominal tax rate. They may also apply to companies, partnerships or other entities established outside the above jurisdictions if the CFC is controlled by an Italian resident; subject to a foreign effective tax rate lower than 50 per cent of the effective tax rate that would have applied if the CFC were resident in Italy; and derives revenues that are, for more than 50 per cent, either passive or from intra-group services.

Italy does not have a part-year residence rule. Indeed, in any calendar year, an individual either is or is not a resident for the whole year. Consequently, if an individual moves to Italy in the second half of the calendar year, he or she will be regarded as non-resident in the year of transfer because the conditions for tax residence will not be met for most of the tax period. This feature of the Italian tax system may allow for the optimisation of the tax regime upon transfer of residence. On the other hand, if an individual moves to Italy in the first half of the calendar year, he or she will be regarded as resident for the whole year of transfer.

Finally, no exit tax is levied on individuals (the exception being for assets held in the capacity of entrepreneur).

### Inheritance and gift tax

Inheritance and gift tax is levied on worldwide assets if the deceased or donor had his or her habitual abode in Italy on the date of demise or gift, otherwise it only applies to Italian *situs* assets.

In particular, transfers upon death and gifts are subject to inheritance and gift tax at the following rates and with the following exempt amounts:

a. 4 per cent if the transfer is made to spouses and direct descendants or ancestors; here, the transfer is subject to tax on the value exceeding €1 million (this exempt amount applies to each beneficiary);

b. 6 per cent if the transfer is made to brothers and sisters; here, the transfer is subject to tax on the value exceeding €100,000 (this exempt amount applies to each beneficiary);

c. 6 per cent if the transfer is made to relatives up to the fourth degree, to persons related by direct affinity as well as to persons related by collateral affinity up to the third degree; and

d. 8 per cent in all other cases.
Same-sex civil unions have been recently introduced under Italian civil law (same-sex marriages or civil unions executed abroad have been assimilated to Italian same-sex civil union). Such introduction has the effect of making them subject to the same tax regime (e.g., rates and exempt amount) applicable to marriages.

The rules for the calculation of the taxable base may be extremely favourable. For instance, the value of unlisted participations in companies or partnerships is generally equal to the corresponding quota of the book net equity of the company or partnership resulting from the latest balance sheet drawn up pursuant to the applicable law. The value of the Italian real estate is, in principle, equal to its fair market value, but the tax office cannot dispute the value declared if it is at least equal to the value resulting from the cadastral registers, which is generally much lower than the fair market value.

Exemptions from inheritance and gift tax may apply to assets of cultural value, while Italian governmental bonds are free from inheritance tax.

An exemption from inheritance and gift tax applies to the transfer of businesses and participations in companies and partnerships to spouses or descendants.

For participations in Italian-resident companies, the exemption is subject to the additional condition that the recipient acquires or reaches a controlling shareholding. The control must be retained for five years following the transfer, otherwise the exemption will be clawed back. The tax authorities have clarified that the exemption would apply to the transfer of a controlling shareholding in joint ownership to a spouse or descendants and may apply to the settlement of a controlling shareholding into a trust for their exclusive benefit. For instance, if an individual holding a 60 per cent participation in an Italian-resident company were to transfer a 30 per cent participation to each of his or her two children, the exemption would not apply. On the other hand, the settlement of the 60 per cent participation into a trust for the exclusive benefit of the two children would qualify for the exemption, provided that the trust was properly structured.

The application of the exemption to non-resident companies is a source of debate. According to one interpretation, the exemption is not available to non-resident companies, which would conflict with EU law, where applicable. According to a second interpretation, the exemption applies to non-resident companies irrespective of the control condition. According to a third interpretation, the exemption applies to non-resident companies under the same control condition applicable to resident companies. In a private ruling dated 2 August 2011, the tax authorities held the third interpretation to be the case.

Finally, individuals who are subject to Italian inheritance and gift tax on their worldwide assets can benefit from the Italian inheritance, estate and gift tax treaties, which may preclude the levy of more burdensome taxes in other jurisdictions. Treaties for the avoidance of double taxation on inheritance and estate tax are in force with Denmark, France, Greece, Israel, Sweden, the United Kingdom and the United States. The treaty with France also covers gift tax. For instance, a UK-domiciled or deemed domiciled individual may transfer his or her habitual abode to Italy and become immediately exposed to Italian inheritance tax on his or her worldwide estate, but, as a consequence, he or she becomes treaty protected from UK inheritance tax on non-UK situs assets.
iii  Wealth taxes

Italian legislation does not provide for a comprehensive wealth tax. In very general terms, wealth taxes apply at proportional rates to the following:

a  Financial assets held in Italy: foreign assets deposited with an Italian financial intermediary should be regarded as assets held in Italy for the purpose of wealth taxes provision. The annual rate is 0.2 per cent. The taxable base is calculated on the basis of the value of the assets laid down in the periodic reports issued by the Italian financial intermediary with which the assets are deposited. Current accounts are subject to tax at a fixed negligible amount.

b  Financial assets held abroad by resident individuals: the annual rate is 0.2 per cent. The taxable base depends on the type of financial asset. In general terms, the taxable base is the trading value for listed assets. In other cases, the taxable base is generally the nominal value. Current accounts are subject to tax at a fixed negligible amount.

c  Real estate located abroad held by resident individuals: the annual rate is 0.76 per cent. The taxable base is generally equal to the purchase price of the real estate, but if the real estate is located in an EU or EEA Member State providing for exchange of information, the taxable base is equal to the value resulting from foreign cadastral registers or other deemed value relevant to foreign income, wealth or transfer taxes and, in the absence of such value, is generally equal to the purchase price.

Another tax applies on the value of Italian real estate, calculated on the basis of the value resulting from the cadastral registers. Favourable tax regimes may apply to, for example, the main abode.

iv  New forfait tax regime for individuals moving to Italy

The Budget Law 2017, which entered into force on 1 January 2017, introduced a special forfait tax regime (the substitute tax regime) for individuals who transfer their tax residence to Italy. This regime is meant to attract high net worth individuals to Italy.

Conditions for the substitute tax regime

The option for the substitute tax regime is available to individuals (whether Italian or foreign nationals) who acquire Italian tax residence. The substitute tax regime is subject to the following conditions:

a  the individual must have been non-resident in Italy for Italian tax purposes in at least nine of the 10 years prior to the first year of effect of the option; and

b  the individual must opt for the aforementioned substitute tax option in the annual tax return.

Substitute tax regime

The substitute tax regime is as follows:

a  all foreign-source income and gains are subject to a substitute tax (in lieu of the levy of income tax according to general rules) equal to €100,000 per year (such income and gains are not subject to any additional taxation if remitted to Italy);

b  foreign assets are not subject to wealth taxes, inheritance and gift tax, and reporting obligations;
as an exception, foreign-source capital gains on substantial shareholdings realised in the first five years of Italian tax residence are subject to income tax according to general rules. As a consequence, during such five-year period, substantial shareholdings are subject to reporting obligations. This exception is a specific anti-avoidance rule and, therefore, depending on the specific facts and circumstances, it can be disapplied through a mandatory advance ruling (e.g., if the taxpayer undertakes to stay in Italy for at least five years after the sale); and

d the individual can opt for one or more foreign states to be excluded from the scope of the substitute tax regime.

**Duration of the substitute tax regime**

The option for the substitute tax regime is effective up to a maximum period of 15 years. The option can be revoked by the individual but, if revoked, is no longer available.

**Possible extension to relatives**

The substitute tax regime can be extended to one or more qualifying family members against the payment of an annual substitute tax of €25,000 (rather than €100,000) per family member benefiting from such a regime. Therefore, if, for example, two spouses transfer their tax residence to Italy and both of them wish to benefit from the substitute tax regime, the overall annual substitute tax would be €125,000.

**Optional ruling procedure**

A ruling on the application of the substitute tax regime may be requested, even before the transfer of tax residence to Italy, to an *ad hoc* office of the Italian tax authorities.

**III SUCESSION**

i **Applicable law**

Italian international private law dealing with successions are laid down in EU Regulation No. 650/2012 of 4 July 2012. The Regulation provides for the general rule whereby the law applicable to the succession as a whole will be the law of the state of habitual residence of the deceased at the date of death. In limited circumstances, the law of the state the deceased was manifestly more closely connected with at the date of death will apply. An individual can, however, opt for the succession law of the state whose nationality he or she possesses either upon the exercise of the option or upon death. In the case of multiple nationalities, the individual can choose the law of any of the states whose nationality he or she possesses. The conflict of law rules provided by the chosen law will not apply.

ii **Forced heirship rules and succession agreements**

*Italian succession law provides for forced heirship rules*

The reserved quota of the estate, which is reserved to forced heirs and, therefore, cannot be freely disposed of, depends on the composition of the family of the deceased upon death. For instance, if the spouse and three children are the forced heirs, 50 per cent of the estate of the deceased is the reserved quota for the children, to be divided in equal shares. In this case, the reserved quota for the spouse is equal to 25 per cent of the estate of the deceased, while the remaining 25 per cent of the estate can be freely disposed of.
For the purposes of calculating the reserved quota, the value of the estate of the deceased is equal to the value of all the assets owned at the time of death, net of any debts, plus the value of all assets that were gifted by the deceased during his or her life.

Italian law provides for the discretionary right of the forced heirs to claim the ‘reduction’ of the transfers made during lifetime or by way of will that prejudice their reserved quota. This clawback action – ‘reduction action’ – if exercised, is aimed at making transfers in excess of the disposable quota partially or totally ineffective. The transfers will remain fully valid and effective should the forced heirs not exercise the reduction action.

Succession agreements are null and void under Italian law, so that an individual cannot waive, or in any other way dispose of, his or her rights, including forced heirship rights, under a future succession.

The ban on succession agreements has only one exception: under a family pact a business, or a qualifying participation in a company carrying on a business, can be transferred to descendants under an agreement between all the living forced heirs, whereby the forced heirs, not receiving their share of the business or of the qualifying participation, may either be granted a cash amount or other assets by the transferees, or renounce, in whole or part, their reserved quota. It is fair to say that the family pact has not been widely used.

IV WEALTH STRUCTURING AND REGULATION

i Trusts

Despite the fact that Italy is a civil law jurisdiction, trusts are widely used, particularly for the purpose of governing the generational transfer of businesses. In this context, the use of trusts may also achieve the exemption from inheritance and gift tax for the transfer of a controlling shareholding (see Section II.ii).

Recognition of foreign trusts

Italian civil law does not regulate trusts, but trusts regulated by foreign laws are recognised in Italy pursuant to the Hague Convention on the Law Applicable to Trusts and on their Recognition, which was ratified by Italy in 1989. Furthermore, in 2016, specific civil law provisions have been introduced to regulate trusts created for the benefit of individuals with qualifying disabilities. In any event, the settlement of assets into a trust is considered a gift from a succession law perspective, therefore it is relevant to the calculation of the value of the estate of the deceased for the purpose of calculating the reserved quota (see Section III.ii).

The issue of the recognition of ‘domestic trusts’ has also arisen. The prevailing case law has taken the view that domestic trusts must be recognised to the extent that they pursue a legitimate interest, but no explicit judgment of the Supreme Court has ever been issued on this specific point.

Tax regime of trusts

Opaque trusts

Income tax provisions recognise trusts as taxable persons for corporate income tax purposes, subject to the comments below on transparent and disregarded trusts.

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2 Trusts whose settlor, beneficiaries and trust property are closely connected with Italy.
A trust qualifies as resident if either its seat of management (similar to the OECD’s notion of a ‘place of effective management’) or its main object (the place where the day-by-day activities mainly take place) are located in Italy for most of the tax period. Deeming rules may apply to trusts established in jurisdictions not providing for exchange of information. Furthermore, the tax authorities take the view that, if a trust holds only real estate and such real estate is located mainly in Italy, its main object is located in Italy, and, accordingly, the trust is resident in Italy.3

Under the assumption that a trust, resident or otherwise, does not carry out a business activity, it may benefit from the 12.5 per cent or 26 per cent final withholding taxes or substitute taxes on income and capital gains from financial assets that would apply to individuals (see Section II.i) and from the exemption from income tax on capital gains on real estate owned for more than five years. Furthermore, anti-avoidance provisions targeting the use of business assets by shareholders or partners or the use of dummy companies or partnerships do not apply to trusts.

**Transparent trusts**

Income tax law provides for a sort of transparency regime for trusts that have ‘identified beneficiaries’. The income imputed to the identified beneficiaries qualifies as income from capital and is subject to progressive tax rates if the beneficiaries are individuals. A beneficiary qualifies as an ‘identified beneficiary’ to the extent that he or she holds a current unconditional right to claim a share of the income generated by the assets held in trust; for example, the whole or a percentage of the income of the trust or the income from certain assets held in trust.

**Disregarded trusts**

Revocable trusts are disregarded for income tax purposes so that the income from the trust assets is imputed directly to the settlor. Furthermore, the income can be imputed directly to the settlor or the beneficiaries should the overall analysis show that either the settlor or the beneficiaries have a power or de facto control or influence to manage the trust assets or dispose of either the assets held in trust or the income from such assets. In these cases, the income is subject to tax as if it were cashed directly by the settlor or the beneficiaries. In Circular No. 61 of 27 December 2010, the tax authorities provided a non-exhaustive list of examples of disregarded trusts, including trusts that can be terminated by the settlor or the beneficiaries, trusts where the beneficiaries have a right to receive advancement of capital and trusts where the settlor has the power to change the beneficiaries. Also, the power of the settlor to revoke the trustee may be one of the factors leading to the trust being disregarded by the tax authorities.4

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3 Circular No. 48 of 6 August 2007.
4 This approach was rejected by the provincial tax court of Novara, judgment No. 73/06/13 deposited on 21 May 2013. More recently, another first degree local court (Provincial tax court of Varese, Chamber 3, judgment No. 305 of 28 May 2015) rejected the assessment of the tax authorities. In particular, the tax authorities claimed that a trust was to be disregarded on the ground that the protector had significant powers, the protector and the beneficiaries had, by way of a joint decision, the power to remove and appoint the trustee ad nutum, and the trustee was entitled to a limited remuneration. On that occasion, the court held that such elements were not sufficient to disregard the trust.
**Distributions of income to the beneficiaries**

The tax authorities clarified that distributions of income from resident opaque trusts are not subject to income tax in the hands of the beneficiaries since the income has already been subject to tax at the level of the trust.\(^5\)

On the other hand, the income tax regime for distributions of income, including capital gains and accumulated income and capital gains, from a non-resident opaque trust with foreign-sourced income to an Italian-resident beneficiary is not clear.

The distributions of income are not relevant to income tax to the extent that the trust is either transparent or disregarded.

**Inheritance and gift tax**

Following the 2006 reform of inheritance and gift tax, the tax authorities hold that inheritance and gift tax will be due by the trustee at the time of the addition of the assets to the trust fund and that the applicable rate and the possible exempt amounts are calculated by making reference to the relationship between the settlor and the beneficiaries (this approach to levy inheritance and gift tax on the addition to the trust fund has been upheld, with reference to trusts created after the 2006 reform of inheritance and gift tax, by the majority decisions of the Supreme Court; in judgment No. 3886 of 25 February 2015, the Court also upheld the view of the tax authorities that, to the extent that the settlor is a beneficiary, the applicable gift tax rate is the highest 8 per cent rate). In certain instances, however, favourable inheritance and gift tax rates and exempt amounts may not be effectively benefited from. For instance, in the event of a discretionary trust having a class of beneficiaries with different degrees of family relationship with the settlor, the highest rate will apply as the capital may be wholly distributed to the family member that qualifies for the highest rate. Exemptions from inheritance and gift tax for the transfer of businesses and participations in companies and partnerships to the spouse or descendants may be feasible (see Section II.ii). From an income tax perspective, the transfer of assets from the settlor to the trustee does not trigger the taxation of the latent gains and the tax basis is rolled over to the transferee.

The tax authorities have further stated that distributions to the beneficiaries will not be a taxable event for inheritance and gift tax purposes, since inheritance and gift tax was applied at the time the addition to the trust fund was made. However, according to the Supreme Court (decisions Nos. 25478, 25479 and 25480 of 18 December 2015), to the extent that the addition to the trust fund occurred prior to the 2006 reform of inheritance and gift tax, the distributions to the beneficiaries should be a taxable event, since the addition of assets to the trust fund was not a taxable event prior to the 2006 reform.

**ii Life insurance policies**

Life insurance policies are widely used thanks to the high flexibility they grant to the policyholder, who can wholly or partly redeem the policy or change the beneficiaries at any time. From an income tax perspective, the income is not taxed until either redemption or death of the insured. In the event of redemption or death, the income is subject to a 26 per cent tax (12.5 per cent to the extent that the income on the underlying capital consists of interest and capital gains on Italian governmental bonds and bonds issued by foreign states providing for exchange of information). The income is equal to the difference between the amount received

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and the premiums paid (so that the policy allows the full set-off of the underlying income, gains and losses); however, in case of death, the beneficiary is exempt from tax on the portion of the income attributable to the life risk component. Finally, transfer to the beneficiary upon the death of the insured is not mortis causa, since the beneficiary has a direct entitlement to the underlying capital, and, accordingly, is not subject to inheritance tax.

iii Gift with reservation of usufruct

The gift of bare ownership with the reservation of usufruct allows the donor, usufruct holder, to continue to enjoy the use of the asset and the income therefrom for his or her lifetime. To the extent that the asset is a shareholding the donor may also retain the voting rights. Gift tax is levied on the value of the bare ownership only. Such value is calculated on the basis of percentages provided by tax legislation and based on the age of the usufruct holder. Upon the death of the usufruct holder, the usufruct is extinguished and the bare owner becomes the full owner of the assets, but the consolidation of bare ownership with usufruct does not qualify as a mortis causa transfer under the Italian civil law. Therefore, it does not trigger the levy of inheritance tax.

iv Non-commercial partnership

The resident non-commercial partnership is widely used, particularly to hold real estate; it may be used to avoid the fragmentation of family real estate. Furthermore, the splitting of voting rights from profit participation rights may be achieved. Individuals other than family members may be prevented from acquiring an interest in the partnership and from being involved in the management of the real estate. The resident non-commercial partnership is fiscally transparent. Therefore, the beneficial regimes applicable to real estate held by individuals are preserved (e.g., the exemption from income tax on gains on real estate owned for more than five years). Furthermore, anti-avoidance provisions targeting the use of business assets by shareholders or partners or the use of dummy companies or partnerships do not apply to the resident non-commercial partnership.

V OUTLOOK AND CONCLUSIONS

The introduction of the new Italian forfait tax regime for individuals moving to Italy (see Section II.iv) has made Italy one of the most appealing European jurisdictions for high net worth individuals to move to. The regime has gained significant success and specific provisions have been issued to ease the granting of entry visas for non-EU nationals.

For those outside the scope of the aforementioned new Italian forfait tax regime, the scope of reporting obligations on foreign-held assets (see above) has been broadened as a consequence of the expansion of the notion of beneficial owner by the EU Directive 2015/849 of 20 May 2015. This expansion is particularly relevant to Italian-resident beneficiaries of non-resident trusts.
I INTRODUCTION

Japan has the world’s third-largest economy, having achieved remarkable economic growth after the Second World War, and private wealth management among business owners and wealthy families has become popular in Japan. However, Japan may not be such a favoured jurisdiction for private wealth management compared to others, largely owing to the significant tax burdens of personal income tax and inheritance and gift tax for wealthy individuals, and there being little room for effective tax planning to lawfully avoid these taxes. Recently, tax reforms have been made to increase the tax burden of wealthy individuals, such as establishing a new marginal tax bracket for personal income tax of taxable income exceeding ¥40 million (45 per cent) and the new ‘exit tax’ regime. On top of this, the recent enforcement attitude of the Japanese tax authority towards wealthy individuals has become very active and rigorous: the media frequently reports that wealthy individuals (e.g., business owners) who planned to avoid taxes were audited and subject to a tax bill of billions of yen as the tax authority did not respect the position taken. These examples seem to be enough to warn wealthy individuals and professional tax advisers against aggressive tax planning, setting aside the option of subsequently disputing the assessment in the courts. The Japanese government’s recent enforcement attitude is probably partially politically motivated, so that in exchange for raising the rate of the consumption tax (i.e., value added tax) from 5 per cent to 8 per cent in April 2014, then from 8 per cent to 10 per cent in October 2019, to be borne by the general public, any dissatisfaction or feeling of unfairness of the general public towards the seemingly low tax burden of wealthy individuals must then be mitigated.

In such an environment, Japanese tax planning considerations for high net worth individuals would inevitably have to shift towards utilising ready-made measures offered by tax laws, rather than using creative or novel structures or techniques – presumably considered by the Japanese tax authority as deviating from the original intent of the relevant tax provision – to pursue no or little tax burden.

II TAX

i Personal income taxation

Resident individuals

Generally, Japanese resident individuals are taxed at regular progressive rates on all types of income under the Income Tax Act (Act No. 33 of 1965, as amended), subject to the

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1 Masayuki Fukuda and Yushi Hegawa are partners at Nagashima Ohno & Tsunematsu.
special tax rules discussed below under the Act on Special Measures Concerning Taxation (Act No. 26 of 1957, as amended). The marginal tax rate of individual income taxation is 55.945 per cent (comprised of 45 per cent national individual income tax, 0.945 per cent special reconstruction income surtax and 10 per cent local inhabitants tax) until 2037. The marginal rate applies to the portion of the taxable income exceeding ¥40 million; this new marginal rate bracket has been effective since 2015. Among others, business income and employment income (including directors’ and officers’ remuneration) are subject to the regular progressive taxation.

Special rules apply to income from financial assets, which are significant for Japanese high net worth resident individuals. Japanese-resident individuals are taxed on capital gains arising from sale of securities (shares, whether private or publicly listed, and bonds for which sufficient disclosures are made) at the flat rate of 20.315 per cent, substantially lower than the 55.945 per cent marginal rate. As for dividends, if the Japanese corporation distributing the dividends is a private or non-listed corporation, Japanese-resident individuals are subject to withholding tax at the rate of 20.42 per cent, and at the same time are subject to the regular progressive taxation to be reported by filing a tax return. Publicly listed corporations are subject to withholding tax at the rate of 20.315 per cent, and will be subject to the separate taxation at the rate of 20.315 per cent to be reported by filing a tax return; provided that, for individual shareholders who own 3 per cent or more of the total issued shares of the publicly listed corporation (typically owners or founders of the business), the treatment will substantially be the same as that for a private or non-listed Japanese corporation mentioned above.

Japanese-resident individuals are subject to the Japanese anti-tax haven or controlled foreign corporation (CFC) rules. As is common with wealthy Japanese-resident individuals, when he or she owns shares of a foreign corporation (e.g., as a holding company), he or she will be subject to these rules and taxed on a pro rata portion of the profits earned by the foreign corporation (i.e., to be aggregated with his or her own income), if, in general: Japanese-resident individuals (including non-resident individuals having certain special relationships with them) and Japanese corporations collectively own, directly or indirectly, more than 50 per cent of the foreign corporation; that particular Japanese-resident individual owns, directly or indirectly, 10 per cent or more of the foreign corporation; and the effective tax burden in a fiscal year of the foreign corporation is less than 20 per cent (less than 30 per cent if the foreign corporation is a certain shell company with little substance or cash-box company). This CFC rule has been overhauled and tightened by the 2017 tax reform, in response to the Base Erosion and Profit Shifting Action Plan 3, and is effective as of April 2018.

Non-resident individuals

Non-resident individuals are taxed in Japan only on certain specifically enumerated types of Japanese source income. Non-resident individuals having no permanent establishment in Japan are, in general, not subject to Japanese taxation on capital gains arising from sale of shares of a Japanese corporation, unless such non-resident individual, together with certain related persons (its affiliates and related parties, etc.) as defined in Japanese tax laws and partnerships in which it is directly or indirectly a partner: owns or owned 25 per cent or more of the total shares of the Japanese corporation at any time during a period of three years on or before the end of the calendar year in which the sale of such shares took place; and sells 5 per cent or more of the total shares of the Japanese corporation in that calendar year.
This exceptional rule is commonly referred to as the ‘25/5 rule’ in practice. If this applies, non-resident individuals are subject to income tax at the flat rate of 15.315 per cent, to be reported by filing a tax return. Special rules apply if the Japanese corporation at issue is a certain real property holding corporation, e.g., Japanese REITs.

As for dividends, if the Japanese corporation distributing the dividends is a private or non-listed corporation, non-resident individuals having no permanent establishment in Japan are subject to withholding tax at the rate of 20.42 per cent. In the case of a publicly listed corporation, it is subject to withholding tax at the rate of 15.315 per cent; provided that, for individual shareholders who own 3 per cent or more of the total issued shares of that publicly listed corporation, the 20.42 per cent withholding tax rate will apply. This taxation is finalised only by the withholding tax (i.e., there is no need to file a tax return).

The foregoing Japanese taxation in Japan on foreign individuals having no permanent establishment in Japan can be modified by an applicable tax treaty between Japan and the country of residence of that foreign individual.

**Exit tax for resident individuals**

Because income taxation for non-resident individuals on financial assets is limited compared to that for resident individuals, particularly taxation on capital gains arising from sale of shares of a Japanese corporation as discussed above, this acts as an incentive for high net worth resident individuals to exit Japan to avoid taxation on the capital gains. Popular destinations for this purpose include Singapore, Hong Kong and Switzerland. To prevent high net worth resident individuals from doing this and so preventing the loss of Japan’s tax revenue, an ‘exit tax’ regime was introduced, effective from 1 July 2015, by an amendment to the Income Tax Act. In general, Japanese-resident individuals owning certain financial assets (shares, bonds, derivatives, etc.) of ¥100 million or more (on a fair market value basis) are now taxed on the unrealised gains on these financial assets at the time of the exit from Japan to be a non-resident individual, as if they had sold such financial assets. While there are some exceptions (e.g., in the case of a temporary job assignment overseas followed by re-entry to Japan within a certain period) this exit tax is now a significant deterrent for high net worth resident individuals to migrate to foreign low-tax jurisdictions.

**Information reporting and disclosure requirements**

The 2012 tax reform introduced a regime of ‘statement of foreign assets’, where Japanese-resident individuals who have foreign assets exceeding ¥50 million (on a fair market value basis) must disclose details of their holdings in the statement of foreign assets. Similarly, the 2015 tax reform introduced a regime of statement of assets and liabilities, where individuals (resident or non-resident) who have to file a tax return and have: taxable income exceeding ¥20 million to be reported; and assets of which the total fair market value as of the end of a calendar year is ¥300 million or more or assets that are subject to the ‘exit tax’ regime of which the total fair market value as of the end of a calendar year is ¥100 million or more.

In the statement of assets and liabilities, individuals must disclose details of their holding of assets and liabilities. Failure to submit these statements will entail a surtax of 5 per cent on top of the penalty tax rate that otherwise applies. These are intended for the Japanese tax authority to collect information on high net worth individuals to effectively enforce the relevant tax laws. These regimes are based on the Act on Submission of Statement of Overseas Wire Transfers for Purpose of Securing Proper Domestic Taxation (Act No. 110 of 1997, as amended).
ii Inheritance and gift taxation

Inheritance tax and gift tax are imposed based on the Inheritance Tax Act (Act No. 73 of 1950, as amended) as follows:

a Japanese national and resident taxpayers, if they are an heir or a donee, are subject to Japanese inheritance and gift tax on worldwide (i.e., Japanese and foreign) assets that they acquired by the inheritance, bequest or gift;

b taxpayers who are Japanese nationals but not Japanese residents are taxed only on Japanese assets (but not on foreign assets), unless either the deceased or donor, or the heir or donee, used to reside in Japan at any time during the 10-year period preceding the commencement of the inheritance, bequest or gift; and

c taxpayers who are neither Japanese nationals nor Japanese residents are taxed also only on Japanese assets, unless the deceased or donor used to reside in Japan at any time during the 10-year period preceding the commencement of the inheritance, bequest or gift.

This means that an attempt to avoid inheritance and gift taxation on foreign assets by becoming a non-resident or even a foreign national has become impractical, since it mandates a ‘waiting period’ of 10 years. Indeed, aiming to discourage such an attempt, the waiting period in the case of (b) above has been extended from five years to 10 years by the 2017 tax reform, and the 2017 tax reform has set a new 10-year waiting period in the case of (c) above.

The marginal inheritance tax rate is 55 per cent if the total value of the inherited assets succeeded to by an heir as a taxpayer exceeds ¥600 million, effective from 2015. Also, effective from 2015, standard deductions for inheritance tax were significantly reduced. This is obviously intended to expand the tax base of the inheritance tax and to increase taxation of high net worth families. The marginal tax rate of gift tax is 55 per cent if the total value of the gifted assets of a donee as a taxpayer exceeds ¥30 million; as such, gift tax can be significantly burdensome when assets of a significant value are gifted, and hence is a deterrent for succession of a business to the next generation.

The value of assets for inheritance and gift tax purposes is measured in accordance with the Asset Valuation Basic Circular of the Japanese tax authority (the Circular). Because room for creative tax planning is rather limited, a major part of the planning in practice is to try to reduce the value of the assets, taking advantage of the Circular. However, the Circular contains a general anti-avoidance provision called General Rule Paragraph 6, and this has been actively invoked by the Japanese tax authority to disallow ‘creative’ (in its view ‘abusive’) tax planning to reduce the value of the assets.

III SUCCESSION

i Overview

After the Second World War, the succession system was transformed in Japan. There are two kinds of succession: testate and intestate. In the case of intestate, the surviving spouse is always an heir. Children of the deceased are heirs of the first rank, the lineal ascendants (parents and grandparents) are heirs of the second rank, and the siblings (brothers and sisters) come third. If there is a spouse and children, the spouse will take half the estate and the remaining half is equally divided among the children, and heirs of the second and third rank have no share.
in the estate. If there is a spouse but no children, the estate is divided between the spouse who takes two-thirds of the estate and the lineal ascendants who take a third. If the lineal ascendants have already died, the spouse takes three-quarters and the siblings take a quarter.

The share of an illegitimate child used to be half of that of a legitimate child. However, the Supreme Court declared\(^2\) that the relevant provision of the Civil Code of Japan (Act No. 89 of 1896 as amended) (the Civil Code) is unconstitutional and invalid and, thereafter, such discriminatory treatment was abolished.

If a prospective heir dies before the deceased, such heir’s lineal descendant will become the heir (in addition, where a child’s lineal descendant also dies before the deceased, such lineal descendant’s lineal descendant will become the heir).

An heir will have a choice to accept or renounce succession. An heir may also accept succession with a reservation by declaring that he or she is liable for the debts of the deceased only up to the amount of the inherited estate. Renunciation or acceptance with reservation will have to be made within three months after he or she has become aware of the death of the deceased and of the fact that he or she is to succeed the estate. He or she must prepare an inventory of the estate and declare renunciation or acceptance at the family court in order to effect renunciation or acceptance with reservation. When an heir fails to renounce or accept succession with reservation within three months, he or she is deemed to have accepted the succession.

If there is no will, the estate of the deceased as well as his or her debts pass directly to the heirs. Until the estate is distributed among the heirs, it will be jointly owned by the heirs and each heir may dispose of its own share. The division of the estate will take effect retrospectively upon the death of the deceased, but the division may not affect the third party who acquires an interest in the estate before the division. Therefore, if an heir sold its share in the succeeded land to a third party before the division, such sale is valid even after the division.\(^3\)

If there is a will, the distribution of the estate will be effected in accordance with the will. Any person over 15 years of age is capable of making a will. A will must follow the strict formalities set forth in the Civil Code. There are three kinds of ordinary wills: a will written in the testator’s own hand (a holographic will); a will by notarised document; and a will by a sealed secret document. A will can be revoked at any time by the testator. However, certain categories of heirs (children, spouses and lineal ascendants, not including siblings) have a secured portion of the estate that they cannot be deprived of, even by will. If the lineal ascendants are the only heirs, a third of the estate will be reserved for them and otherwise, half of the estate will be reserved.

Under the bill of amendments to the Civil Code currently deliberated in the Diet, various amendments to the succession system will be made, including the following:

\(a\) the spouse of the deceased may continue to live at the residence of the deceased so long as he or she is alive;

\(b\) holographic wills may be deposited at legal affairs bureaus;

\(c\) a provisional payment from bank deposits of the deceased will be permitted in urgent cases where it is necessary to do so (see Section III.ii);

\(^2\) Supreme Court Decision, 4 September 2013, Minshu 67-6-1320.

\(^3\) Supreme Court Judgment, 28 April 1967, Minshu 21-3-780.
gifts made 10 years or more before the commencement of succession will not be counted in the calculation of the statutory reserved portion of the estate for certain heirs; and

an heir’s succession of estate beyond its statutorily predetermined portion may not be perfected against third parties unless such succession is registered.

ii Recent Supreme Court change of rule

Under a previous judgment of the Supreme Court,4 the bank deposit in the estate of the deceased was automatically divided in proportion to the statutorily determined ratio of succession and belonged to the statutory successors upon the death of the deceased. However, in 2016, the Supreme Court5 changed its former view and held that the bank deposit in the estate of the deceased will not be automatically divided upon the death of the deceased and shall be dealt with by the division of the estate agreed or conciliated between the heirs or adjudicated by the family court.

iii Conflict of law rules

Under the Japanese conflict of law rules, in general, the succession is governed by the laws of the deceased’s nationality. The execution and effect of a will shall be governed by the laws of the testator’s nationality when the will is executed. However, Japan has ratified the Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions and pursuant to the domestic law enacted thereunder, a will will be legally valid if a will complies with:

a the laws of country where the will is executed;

b the laws of the country of the testator’s nationality when the will is executed or the testator is dead;

c the laws of the country of the testator’s domicile when the will is executed or the testator is dead;

d the laws of the country of the testator’s habitual residence when the will is executed or the testator is dead; or

e in the case of a will regarding immovable property, the laws of the country where such immovable property is located.

iv Applicable changes affecting personal property

While prenuptial agreements are not very popular in Japan, a couple may execute an agreement regarding their properties (couple’s property agreement) prior to the filing of their marriage notice to the authority pursuant to the Civil Code. Such agreement shall be registered at the Legal Affairs Bureau so that it may be legally claimable against their heirs or other third parties.

No legislation has been made regarding same-sex marriage and, therefore, no particular legal protection has been given to same-sex couples in Japan. Recently, some local municipalities enacted certain local regulations under which the municipality commenced to

4 Supreme Court Judgment, 8 April 1954, Minshu 8-4-819.
5 Supreme Court Judgment, 19 December 2016, Hanta 1433-44.
issue ‘partnership certificates’ to same-sex couples, although the legal effect of such certificates is not clear; arguably, a same-sex couple with such certificate might be treated the same as a de facto heterosexual couple.

IV WEALTH STRUCTURING AND REGULATION

i Vehicles and structures

Asset holding companies

Companies and corporations are the most widely used vehicles for wealth management in Japan. Typically, two types of companies will be available: a stock company and a limited liability company. Equity-holders of these companies are responsible for the financial obligations of the companies only to the extent of the subscription price paid for the equities owned by such equity-holders. A stock company is divided into two types: public companies and non-public companies. The shares of a public company shall be limited to transfer-unrestricted shares. Meanwhile, the shares of a non-public company may include transfer-restricted shares that may not be transferred without the company’s permission. The term public or non-public as used here is a technical term, and is not equal to whether the company’s shares are publicly listed or not. A limited liability company is modelled after a US LLC and may be converted into a stock company, which makes it a useful vehicle for start-up companies. When the shares in listed companies are transferred to asset holding companies, a large volume of shareholding reports or their amendment reports or extraordinary reports may be required to be filed with the financial authority and may also be subject to TOB regulations and insider trading regulations under the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended). To prevent disputes among family members in the future succession, it is recommended that the number of asset holding companies is the same as the number of family members (e.g., if there are two children and a spouse, three asset holding companies should be set up).

For high net worth individuals who own a business in the form of shares of a Japanese company operating the business (in many cases this is a publicly listed company), a Japanese asset holding company privately owned by the owner-individual is widely used. This is because dividends paid by the Japanese operating company to the Japanese asset holding company will be (except for a portion corresponding to interest on debts) exempt from corporation tax at the asset holding company’s level (i.e., dividend received deduction), if the asset holding company owns more than a third of the outstanding shares of the Japanese operating company generally for six months or more before the record date for the relevant dividend. This effectively enables deferral of taxation at the level of the owner or individual on the dividends paid by the Japanese operating company, and he or she can avoid the 20.42 per cent withholding tax and the regular progressive taxation had he or she owned the shares directly. In addition, from a viewpoint of valuation for inheritance and gift tax purposes under the Circular, if the asset holding company is well structured so that it will not fall under a certain specified share or real property holding company, the valuation of the shares of the private asset holding company may be made by taking into consideration the share prices of some other similarly situated listed companies, without being bound solely by the market price of the underlying shares of the publicly listed Japanese operating company, which may result in a substantially lower valuation under the Circular. We should note,
however, that the tax authority has recently often challenged structures using shell holding companies with a view to reducing the valuation under the Circular, by invoking the General Rule Paragraph 6 and by looking to the economic substance of such structures.

There are cases where an owner or individual has a private asset holding company that is a foreign company in some tax-favourable jurisdictions. In this case, the foremost concerns include application of the CFC rules as tightened by the 2017 tax reform, and a permanent establishment risk in Japan (where the owner manages everything for the holding company in Japan).

**Associations and foundations**

Associations and foundations are also popular vehicles for a family's wealth management in Japan. An association or foundation that does not intend to distribute its surplus may be established as a general-association judicial person or a general-foundation judicial person by just registering them without having to demonstrate their public purpose. They may apply for non-profit status as a public-interest-association judicial person through the office of the Prime Minister or a regional governor of prefecture, which then will establish committees consisting of private sector specialists to examine the public interest character of the applicant.

The gift or donation of an asset to public-interest-association judicial persons will generally be deductible as a qualified donation for the donor’s income or corporation tax purposes. The gift or donation of appreciated assets (e.g., shares of the Japanese operating company) by a resident individual to public-interest-association judicial persons (and certain other qualifying corporations) may be exempt from capital gains taxation subject to a specific approval of the tax authority. Public-interest judicial persons are generally not subject to corporation tax on income from non-profit public activities. As such, public-interest association or foundation judicial persons are often used as a vehicle to own the shares of the publicly listed Japanese operating company as transferred from the owner or individual, as a stable shareholder that would prevent hostile takeovers of the Japanese operating company. Also, by doing so, the owner or individual can alienate these shares from his or her inheritance estate to reduce the future inheritance tax burden.

**Trusts**

Traditionally, trusts have been used as substitutes for bank deposits and securities investments, or as vehicles for securitisation or other commercial transactions. Recently, however, they have become popular as vehicles for succession of business from the owner to its families (as substitute for a will) or for other wealth management purposes.

Trusts may be set up under the Trust Act (Act No. 108 of 2006, as amended). If the granter entrusts its properties to a trust, such properties will not be affected by the bankruptcy of the grantor or the trustee (bankruptcy remoteness) and the trusted properties are managed and disposed of solely by the trustee pursuant to the trust certificate. By setting up the trust, the grantor acquires the trust beneficial interests and may transfer such interests to a third party more smoothly than the trusted assets such as securities or real estates.

For tax purposes, a plain-vanilla trust (defined as a 'beneficiary-taxed trust') is, in general, treated as a conduit (i.e., a holder of the trust's beneficial interests will be deemed to directly own the underlying entrusted property). That is, a beneficiary-taxed trust cannot generally achieve deferral of taxation on income arising from the entrusted property, or alienation of the
underlying entrusted property from the inheritance estate for tax purposes. Although there are two other types of trust, the tax regime is so strict and straightforward that there is little room for creative and effective tax planning using trust (including a beneficiary-taxed trust).

ii Anti-money laundering and other regimes

In Japan, money laundering of proceeds from certain serious crime is prohibited under the Narcotics Special Provisions Act (Act No. 94 of 1991, as amended) and the Punishment of Organised Crimes and Control of Crime Proceeds Act (Act No. 136 of 1999, as amended). Furthermore, to prevent money laundering and terrorist financing, the Criminal Proceeds Transfer Prevention Act (Act No. 22 of 2007, as amended (the Criminal Proceeds Act)) requires that specified business operators (SBOs) such as financial institutions and real estate agents: verify the counterparty of the transaction; prepare and preserve records of such verification and transaction; and report any suspicious transactions to the relevant authority.

In 2016, responding to the Financial Action Task Force’s critical statement, the Criminal Proceeds Act was amended in various points, such as:

a an amendment to the procedures for assessment of suspicious transactions;

b SBOs were obliged to confirm that a new counterparty of transactions had adopted a similar level of internal anti-money laundering measures;

c expanding SBOs’ obligations upon adopting internal anti-money laundering measures; and

d a requirement of strict verification when making transactions with foreign politically exposed persons, etc.

As a result of such amendments, anti-money laundering legislation became closer to other developed nations’ anti-money laundering regimes. In 2018, the Japanese Financial Services Agency also adopted the ‘Guideline on Anti-Money Laundering and Counter-Terrorist Financing’, which requires financial institutions to facilitate their internal risk management systems on risk-based approach.

While not yet enacted, it is reported that the government is planning to introduce reporting obligations for tax professionals and promoters who are involved in certain tax planning, in response to the BEPS Action Plan 12.

V OUTLOOK AND CONCLUSIONS

The current direction is to tighten taxation on wealthy individuals in Japan, both as a matter of tax policy and legislation and enforcement. As to enforcement, the tax authority has recently established divisions specialising in monitoring and auditing wealthy individuals; as such, the enforcement is expected to be much more active and rigorous. On the other hand, regarding taxpayers, the issue is not limited to tax or money – many wealthy individuals care about their reputation and so want to avoid sensational press reports that they under-reported their tax liability. This reputational risk tends to deter wealthy individuals from creative or novel tax planning at the outset because of the press coverage that appears once they are subject to an assessment, and even if they later win in the courts, it would not necessarily lessen the damage to their reputation. Therefore, in the Japanese wealth management practice, what is sought from professional tax advisers may not be technical ability or creativity, but a way of ascertaining whether the Japanese tax authority is likely to find the planned transaction as abusive or excessive tax planning.
INTRODUCTION

In recent years Liechtenstein has continued to improve the legal framework for wealth structuring and succession planning and to adjust to international developments.

On 1 January 2011, the totally revised Liechtenstein Tax Act entered into force. With the new Act Liechtenstein introduced an attractive tax system, which complies with European law.

With a corporate tax rate of 12.5 per cent and the reduction of the effective tax rate even further through the notional interest deduction, Liechtenstein has joined the league of most tax-efficient jurisdictions by European standards. Furthermore, the taxation of legal entities as private asset structures (PAS) offers an attractive way for individuals to structure their wealth.

Liechtenstein is also an interesting jurisdiction for individuals to take residence. The top income tax rate for a resident of the capital, Vaduz, is 20 per cent. Income from assets that are subject to wealth tax is not taxed directly. Instead, tax is currently levied on a notional income of 4 per cent of the tax value of these assets. Moreover, a favourable lump-sum taxation regime is available for foreigners, and there is no inheritance or gift tax.

Liechtenstein has a long-standing tradition of private family foundations that continue to be attractive vehicles for wealth preservation and succession planning. With the latest reform of the Liechtenstein Foundation Law in 2009, a new foundation governance structure was implemented, providing for more checks and balances regarding the interests of the founder, the beneficiaries and the foundation itself, while the favourable opportunities for wealth planning have fully been preserved. The rules regarding the enforcement of forced heirship rights were amended, resulting in considerably more room for estate planning.

Liechtenstein has a long history of its own trust law. In 1926, Liechtenstein incorporated the institution of the trust, based on the English Trust Act of 1925, into national law. Since then, the Liechtenstein trust has developed into a popular vehicle for wealth structuring and succession planning.

Furthermore, with the implementation of the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) of the European Union into national law, Liechtenstein has incorporated a new investment fund referred to as a ‘Smart Fund’, which provides another internationally recognised, tax-neutral vehicle for structuring private wealth.
II TAX

i Taxation of trusts

Trusts managed from Liechtenstein are subject to an annual tax of 1,800 Swiss francs. No tax filings are necessary.

ii Regular taxation of legal entities

Corporate tax rate and tax base

Legal entities that are taxable in Liechtenstein are subject to corporate tax on their net income at a rate of 12.5 per cent under regular taxation rules.\(^2\)

The net income is reduced by income from foreign permanent establishments, rental and lease income from foreign real estate, gains from selling real estate, distributions from foundations or trusts, dividends and capital gains on the sale of shares and unrealised capital gains on shareholding in companies both in Liechtenstein and abroad.\(^3\) In general, dividend income and capital gains from the sale of shares are tax-exempt. As a result, not only income and capital gains from interests in partly or wholly owned subsidiaries, but also income and capital gains from shares held as part of a securities portfolio, are in principle tax-free.

However, in 2016, a number of the Organisation for Economic Co-operation and Development (OECD)’s Base Erosion and Profit Shifting (BEPS) measures were implemented in the Liechtenstein Tax Act. As a result, dividend income is no longer tax exempt if: (1) the shareholding in the respective subsidiary amounts to at least 25 per cent of the capital or voting rights; and (2) the share of profits are treated as expenses deductible for tax purposes by the subsidiary.\(^4\) This means that if a Liechtenstein entity receives dividend income which for some reason is classified as tax deductible interest payment in the country where the dividend was declared, Liechtenstein will be forced to tax the dividend if the 25 per cent holding threshold is met.

In addition, the Liechtenstein Tax Act will be further amended in 2018, implementing the European Anti Tax Avoidance Directive. It is expected that losses resulting from a sale or impairment of participations will no longer be tax-deductible as of 2019 in order to terminate the asymmetric treatment of (tax-free) profits and tax-deductible losses.

Further, a ‘switchover’ rule will be introduced to ensure that taxable income resulting from a shareholding in a foreign entity, which has predominantly passive income and is subject to low (or no) taxation in its home state, will be additionally taxed in Liechtenstein. This ‘switchover’ from a tax-free dividend to taxable income applies if a Liechtenstein entity receives a dividend from a foreign tax-resident entity that has more than 50 per cent passive income over a multi-year period, if the foreign taxation, directly or indirectly, amounts to less than 50 per cent of this tax. With regard to taxation at less than 50 per cent of this tax, a distinction is made depending on the percentage of the shareholding in the foreign entity. Lower taxation is assumed if the shareholding is:

\[\begin{align*}
\text{a} & \quad \text{lower than 25 per cent and the local tax rate is less than 6.25 per cent; or} \\
\text{b} & \quad \text{more than 25 per cent and the effective taxation is less than 50 per cent in a comparable domestic case.}
\end{align*}\]

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\(^2\) Article 61 of the Tax Act.

\(^3\) Article 48 of the Tax Act.

\(^4\) Article 15, Paragraph 2, Item n of the Tax Act.
This ‘switchover’ rule will also apply as of 2019, but legal entities existing on 1 January 2019 will only become subject to the new regime in 2022.

**Notional interest deduction**

The new tax law introduced a notional interest deduction, which is currently 4 per cent of the modified equity as a deemed expense to ensure equal treatment of debt and equity.

The modified equity is calculated by deducting the following items from the net equity:

- **a** own equity;
- **b** shares in legal entities;
- **c** assets not required for the company’s purposes; and
- **d** a deduction of 6 per cent of all assets, under exclusion of items (a) to (c).\(^5\)

The reason for the first three deductions is that they produce tax-exempt income and capital gains and, therefore, cannot be used to create a notional interest deduction. The term ‘all assets’ refers to the balance sheet total.\(^6\) In case of 100 per cent equity funding, the effective notional interest deduction is reduced from 4 per cent to 3.76 per cent because of the deduction of 6 per cent of the total of all assets (100 per cent – 6 per cent = 94; 94 x 4 per cent = 3.76 per cent).

The table below shows the effects of the notional interest deduction, assuming 100 per cent equity financing for various return-on-equity (ROE) scenarios and the resulting earnings before interest and taxation (EBIT). It is evident that the notional interest deduction can result in a substantial reduction of the effective tax rate. Obviously, the effect is higher the closer the ROE is to the 3.76 per cent effective notional interest deduction. However, even in the case of a highly profitable company yielding a 20 per cent ROE, the notional interest deduction results in a decrease of the effective tax rate from 12.5 per cent to 10.15 per cent.

<table>
<thead>
<tr>
<th>ROE</th>
<th>3.76%</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity (before deduction of 6% of all assets)</td>
<td>1 million</td>
<td>1 million</td>
<td>1 million</td>
<td>1 million</td>
<td>1 million</td>
</tr>
<tr>
<td>Equity (after deduction of 6% of all assets)</td>
<td>940,000</td>
<td>940,000</td>
<td>940,000</td>
<td>940,000</td>
<td>940,000</td>
</tr>
<tr>
<td>EBIT</td>
<td>37,600</td>
<td>50,000</td>
<td>100,000</td>
<td>150,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Notional interest deduction (3.76%)</td>
<td>37,600</td>
<td>37,600</td>
<td>37,600</td>
<td>37,600</td>
<td>37,600</td>
</tr>
<tr>
<td>Profit before taxes</td>
<td>0</td>
<td>12,400</td>
<td>62,400</td>
<td>112,400</td>
<td>162,400</td>
</tr>
<tr>
<td>12.5% corporate tax</td>
<td>0</td>
<td>1,550</td>
<td>7,800</td>
<td>14,050</td>
<td>20,300</td>
</tr>
<tr>
<td>Effective tax rate</td>
<td>0</td>
<td>3.10%</td>
<td>7.80%</td>
<td>9.37%</td>
<td>10.15%</td>
</tr>
</tbody>
</table>

Since the revision of the Tax Act in December 2014, in cases of receivables from shareholders, founders, beneficiaries or related persons carrying an interest rate of less than 4 per cent, the interest rate differential between the interest paid to the legal entity by the related person and the notional interest deduction will generally be excluded in the calculation of the notional interest (except if such receivables from related person result from the main activity of the entity).\(^7\)

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\(^5\) Article 54 of the Tax Act; Article 32 of the Tax Ordinance.

\(^6\) BuA No. 48/2014, 33.

\(^7\) Article 54 Paragraph 3 of the Tax Act.
**IP box**

In 2011, Liechtenstein introduced a notional expense, which may be deducted from any income from intellectual property (IP) rights. The notional expense amounts to 80 per cent of the respective net income. This IP box regime was approved by the European Free Trade Association (EFTA) Surveillance Agency (ESA) in its decision of 1 June 2011. However, in the course of the BEPS action plan, the OECD has defined new taxation standards for IP box regimes, referred to as the modified nexus approach. Like many other countries, Liechtenstein is now implementing the measures of the OECD BEPS action plan. Liechtenstein’s government therefore abolished the IP box regime after the 2016 tax year. However, taxpayers who already take advantage of the Liechtenstein IP box regime will be allowed to benefit from it until 2020.

### iii Taxation as a private asset structure

As an alternative to regular company taxation and inspired by Luxembourg’s private asset management company, the Liechtenstein legislature devised a new tax privilege for legal entities that are only engaged in the management of their own assets and do not perform any commercial activity. A PAS is only subject to the minimum corporate income tax of 1,800 Swiss francs annually without having to file any tax returns. Taxation as a PAS was approved by the ESA as being compliant with the European competition law on 15 February 2011.

The main feature with regard to the tax privilege is the lack of commercial activity. Article 64, Paragraph 1(a) of the Tax Act exemplifies, by reference to the Asset Management Act, what is not considered a commercial activity. This includes the acquisition, possession, management and sale of transferable securities such as bonds, stocks, money market instruments, shares in investment undertakings and derivatives.

Likewise, buying, holding and selling of precious metals, artwork and similar assets is generally possible. In its decision approving the provisions on the PAS, however, the ESA indicates that transactions in securities when effected ‘as part of a commercial share dealing activity’ constitute economic activity. Regular and active trading of securities (and other assets) is therefore not considered permissible for a PAS unless decisions are delegated to an independent asset manager. The purchase and sale of securities as part of a long-term investment strategy is, however, allowed in any event.

As the mere exercise of ownership and the granting of benefits by the entity to its shareholders or beneficiaries are not considered commercial activities, the holding of a property does not constitute a commercial activity as long as the property is used by the PAS or its shareholders and beneficiaries and no rent is charged.

When a PAS holds shares in a subsidiary that exercises a commercial activity, neither the PAS nor its shareholders or beneficiaries are allowed to exercise any control over the management of the subsidiary through direct or indirect influence, otherwise the PAS itself will be regarded as commercially active and lose its status as a PAS.

When comparing regular taxation with PAS taxation, it turns out that in some cases there may be only a small difference in the tax burden because, even in cases of regular taxation, the income from the management of the legal entity’s own assets tends to be tax-exempt anyway.

The following table shows where PAS taxation has advantages over regular taxation:
### Investment Revenues

<table>
<thead>
<tr>
<th>Investment</th>
<th>Revenues</th>
<th>Regular taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(12.5% corporate tax)</td>
</tr>
<tr>
<td>Shares</td>
<td>Dividends</td>
<td>Tax-free</td>
</tr>
<tr>
<td></td>
<td>Realised capital gains</td>
<td>Tax-free</td>
</tr>
<tr>
<td>Bonds</td>
<td>Interest</td>
<td>Taxable if net profit exceeds the 4% notional interest deduction</td>
</tr>
<tr>
<td></td>
<td>Realised capital gains</td>
<td>Taxable if net profit exceeds the 4% notional interest deduction</td>
</tr>
<tr>
<td>Commodities (physical, e.g., gold in a safe)</td>
<td>Realised capital gains</td>
<td>Taxable if net profit exceeds the 4% notional interest deduction</td>
</tr>
<tr>
<td>Real estate (non-Liechtenstein)</td>
<td>Rent</td>
<td>Tax-free</td>
</tr>
<tr>
<td></td>
<td>Realised capital gains</td>
<td>Tax-free</td>
</tr>
<tr>
<td>Derivatives</td>
<td>All income</td>
<td>Taxable if net profit exceeds the 4% notional interest deduction</td>
</tr>
<tr>
<td>Investment funds</td>
<td>Treated as transparent; investments of the fund are treated as being held directly by the legal entity</td>
<td>Yes (except pure stock or property funds)</td>
</tr>
</tbody>
</table>

The table shows that a Liechtenstein legal entity that is taxed as a PAS does not have any tax advantage over a regularly taxed company if it only holds shares, or real estate outside Liechtenstein. The reason is that even under regular taxation any income or capital gains produced by these asset classes will generally be tax-free anyway. In the case of the other asset classes, whether taxation as a private asset structure is preferable over regular taxation depends on whether the asset classes yield more than the 4 per cent notional interest deduction applying in case of regular taxation.

### iv Taxation of individuals

#### Income and wealth tax

##### Personal tax liability

The Liechtenstein tax regime for the taxation of individuals combines income and wealth tax. The wealth tax is based on the notional income of currently 4 per cent on the taxpayer's assets, which is then subject to income tax in lieu of the real income from such assets (which is tax-free). There is an eight-stage scale for determining the income tax.

Individuals having their residence or habitual abode in Liechtenstein are taxable on their entire wealth and income. While residence means the place where a person lives with the intent of staying permanently, habitual abode refers to the place or area in which a person dwells not only temporarily. The Liechtenstein Tax Act considers a temporary continuous abode of more than six months as habitual abode, whereby short-term interruptions are not taken into account.

Limited tax liability applies to individuals whose residence and habitual abode is not in Liechtenstein. Such individuals are taxable in respect of their Liechtenstein wealth and income.

##### Subject of income tax

All income in money and money’s worth is subject to income tax such as:

- any income from self-employment;
- any income from employment relationship under private or public law;
- any income of board members, foundation council members and members of similar bodies of legal entities and trusts that they receive for their respective functions; and
Contributions received by the taxpayer as beneficiary, unless this is subject to wealth tax.\(^8\)

Tax-exempt income includes income from wealth for which the taxpayer pays wealth tax, recurring benefits to the taxpayer, which are considered as taxable wealth, and income from permanent establishments abroad.

**Subject of wealth tax**

The entire movable and immovable wealth of the taxpayer is subject to wealth tax. Individuals with limited tax liability are only taxable in respect of their domestic wealth that is real estate and permanent establishments in Liechtenstein.\(^9\)

The Tax Act provides for certain exemptions from wealth tax. In particular, real estate and permanent establishments abroad are exempted from wealth tax. Taxpayers are also entitled to make certain deductions, such as reducing assets by debts and other liabilities, provided that the taxpayer is liable as principal debtor.

**Trusts or foundations with Liechtenstein-resident settlors or beneficiaries**

With regard to trusts, foundations and similar vehicles with Liechtenstein residents as settlors or beneficiaries, the following rules apply.

The wealth of revocable foundations, trusts and establishments with a foundation-like structure is attributed to the founder and wealth tax is paid by the founder. However, it is possible to opt for taxation at the level of the trust, foundation or similar structure instead.

In the case of irrevocable trusts, foundations and establishments with a foundation-like structure, a distinction is made between entities with determinable beneficiaries that benefit from a certain quota and entities where this is not the case.

In the case of trusts, foundations or establishments with a foundation-like structure with determinable beneficiaries entitled to a certain quota, wealth tax is levied at the level of the beneficiaries. However, the beneficiaries may apply for taxation at the level of these structures but require the consent of the body responsible for distributions. Such a structure will not become the taxpayer itself but rather must meet the wealth or personal tax liability in lieu of the beneficiaries.\(^10\)

If such structures have no determinable beneficiaries entitled to a certain quota, no wealth tax is payable because the wealth cannot be attributed to any natural persons; however, if such structures are established by Liechtenstein tax residents, the set-up itself triggers a special tax as follows.

Such transfers to a discretionary structure are subject to taxation to the extent that: this wealth is no longer subject to wealth tax; and benefits or shares do not become liable to wealth tax.\(^11\) For example, the first prerequisite is not met if real estate abroad is transferred as this is exempted from wealth tax.

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8. Article 14(2) of the Tax Act.
10. Draft Bill (BuA) No. 48/2010, 75.
11. See Article 13(1) of the Tax Act.
The taxation of transfers to a fiduciary structure also applies in the event of changing circumstances after the establishment of a fiduciary structure that led to a shortfall of the wealth tax liability. As a result, the conversion of a determinable benefit into a discretionary benefit also leads to taxation.\(^\text{12}\)

The transferor shall pay a tax in the amount of 3.5 per cent of the wealth tax value of the contribution plus the applicable municipal surcharge. If a tax resident of Vaduz (where the municipal surcharge is 150 per cent) establishes a foundation or trust where no quota can be attributed to the beneficiaries and, therefore, the assets are no longer subject to wealth tax, the set-up is therefore taxed at a rate of 8.75 per cent. The assets will then no longer be subject to wealth tax. However, any distributions from such a foundation or trust to a beneficiary who is a Liechtenstein tax resident will be subject to income tax.

**Tax calculation**

The taxation of individuals is based on a combination of wealth and income tax: the wealth tax is integrated into the income tax by transforming a part of the wealth into an additional category of income. This transformation is based on a notional income.\(^\text{13}\) To determine the taxable base, wealth and income are calculated separately and then a notional income from the wealth is assumed. The interest rate for determining the notional income from wealth is determined annually in the Finance Act, being 4 per cent for 2018. This notional income from taxable wealth is then considered income (instead of the real income) and added to the total taxable income.

After basic exemptions up to 15,000 Swiss francs (and up to 22,500 Swiss francs in the case of single parents within the meaning of the Family Allowance Act and up to 30,000 Swiss francs for jointly assessed married couples), taxable income (including the notional income resulting from wealth tax) is then taxed at different rates for eight income brackets, with the highest rate for the national income tax being 8 per cent. Additionally, the Liechtenstein communities may levy a municipal surcharge of between 150 per cent and 250 per cent on the national tax. Currently, all Liechtenstein communities levy a surcharge of between 150 per cent and 200 per cent on the national income tax, with the rate in Vaduz being 150 per cent. The top tax rate for a resident of Vaduz therefore amounts to 20 per cent and applies in the case of a non-married taxpayer without children if his or her annual income exceeds 200,000 Swiss francs.

**No inheritance or gift tax**

Inheritance tax and gift tax have been abolished in the course of the revision of the Liechtenstein Tax Act. Under the new Liechtenstein tax regime, just a disclosure of donations to the fiscal authority is required. Liechtenstein-resident donors and recipients of gifts must therefore include gifts in their tax returns. The purpose of this notification is to enable comprehensibility of declarations of wealth set out in the tax returns of these individuals (i.e., the information is only declaratory).\(^\text{14}\) The disclosure requirement applies only to gifts, inheritances and bequests exceeding 10,000 Swiss francs.

\(^{12}\) BuA No. 48/2010, 83.
\(^{13}\) BuA No. 48/2010, 25.
\(^{14}\) BuA No. 48/2010, 187.
Lump-sum taxation

Individuals can apply to the fiscal authority for lump-sum taxation (i.e., apply for taxation on expenditure instead of income and wealth tax). The latter does not apply to real estate in Liechtenstein, which remains subject to wealth tax.

Liechtenstein citizens are not entitled to apply for such lump-sum taxation. Another prerequisite for the application is that the individual takes residence or habitual abode in Liechtenstein for the first time or after an absence of 10 years or more from Liechtenstein. The individual must not be entitled to work in Liechtenstein but shall live on income from his or her wealth or other receipts from abroad.

The discretionary decision regarding the lump-sum taxation is up to the Liechtenstein fiscal authority. The lump-sum taxation considers the total expenditure of the taxpayer, and the tax based on the expenditure amounts to 25 per cent of the expenditure. The tax may be determined for several years depending on the regularity of the amount of the expenditure.

Individuals intending to apply for lump-sum taxation must also take into account the applicable provisions in conjunction with the permission to reside in Liechtenstein. Currently, residence permits are quite restricted, although there is a lottery open to citizens of the European Economic Area. Furthermore, several times in the political process there have been discussions to issue more resident permits to wealthy or highly qualified foreigners but no final conclusion has been reached.

III SUCCESSION

Generally, under the Liechtenstein Private International Law Act, all aspects of legal succession are governed by the law of citizenship of the deceased, which will be applied by the Liechtenstein courts. Foreign testators and Liechtenstein nationals living abroad may, however, choose the law of the country of their last residence instead, which offers some planning opportunities.

The enforcement of forced heirship rules against Liechtenstein trusts, foundations and other fiduciary structures has been the subject of several court cases and has consequently led to actions by the Liechtenstein legislator.

Forced heirship rules allocate a part of the assets to the disposition of the testator and another part to certain family members. Generally, contributions of assets to a foundation may be disputed by the heirs in the same way as a donation. If Liechtenstein inheritance law applies, upon request of a child, the spouse or the registered partner entitled to a compulsory portion, donations by the testator must be taken into consideration in the computation of the estate. The subject of the donation must be added to the estate. If the estate is insufficient to cover the forced heirship claims because of the transfer of assets by the deceased to a foundation, the subject of a potential challenge is not the foundation itself but the transfer of assets to the foundation.

15 See Article 33 of the Tax Act.
16 Article 552, Section 38(1) of the Persons and Companies Act (PGR). This provision shall refer to Sections 785 and 951 of the Civil Code (ABGB) entitling the heirs to challenge. See BuA No. 13/2008, 122.
17 See Section 785(1) of the ABGB.
18 See BuA No. 13/2008, 122.
Donations to persons not entitled to a compulsory portion that have been made more than two years prior to the donator’s death are disregarded.\(^{19}\) This fairly short period\(^{20}\) also applies to contributions to a foundation, with the caveat that its commencement depends on the structure of the foundation. In particular, the period does not start before the founder’s death if the assets have not really been economically transferred to the foundation prior to his or her death. Assets are not deemed entirely separated from the founder if he or she has reserved rights to revoke the foundation and to amend the foundation documents;\(^{21}\) however, it has been argued that even where the foundation documents provide a revocation right, the statute of limitations starts with the setting up of the foundation if the foundation documents refer to a third party as ultimate beneficiary in the case of a revocation. The founder is also entitled to waive such rights: upon waiver of such rights set out in the foundation documents, the two-year period shall also start.\(^{22}\) The Liechtenstein Supreme Court recently stated that a revocation right is not the only indication that the assets have not been separated from the founder, and therefore the two-year period has not started to run. Rather, any circumstances indicating the control of the foundation by the founder must be taken into account.\(^{23}\)

If the founder is not a citizen of Liechtenstein and not resident in Liechtenstein, his or her entire estate is governed by law of the country whose citizen he or she was at the time of his or her death (unless the founder chose the law of the country of his or her last residence instead in a will). That law will also apply to the questions of whether there is a forced share for certain family members and whether such compulsory heirs can challenge transfers to a trust or foundation under certain circumstances. As a result, if a foreign resident has established a Liechtenstein trust or foundation, any challenge of the transfer of assets will generally be based on the law governing his or her estate, not on Liechtenstein compulsory heirship law. Accordingly, the Liechtenstein Supreme Court has allowed claims of foreign heirs in several cases based on the applicable foreign heirship law, irrespective of the fact that the Liechtenstein two-year statute of limitations had expired.

However, the newly introduced Article 29, Paragraph 5 of the Liechtenstein Private International Law Act installed another barrier to any challenges,\(^{24}\) saying that the heirs are entitled to claims for a compulsory portion only if they are entitled in the same way under the laws governing the acquisition of the assets by the foundation or trust. Therefore, disputes by persons entitled to a compulsory portion of contributions to a Liechtenstein foundation made by its foreign founder must be possible both under the applicable inheritance law and under Liechtenstein law if Liechtenstein law had been chosen as the law governing the transfer or if Liechtenstein law is applicable because the funds were transferred to the foundation as part of its stated capital. As a result, if Liechtenstein law applies to the contributions to the foundation, the Liechtenstein rules regarding the statute of limitation will be applicable.\(^{25}\)

\(^{19}\) Pursuant to Section 785(3) of the ABGB, donations that the testator made out of current income for charitable purposes in accordance with moral duty or consideration of decorum without diminishing the substance of property will also be disregarded.

\(^{20}\) See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 685 with references to Germany and Switzerland.


\(^{22}\) See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 687.

\(^{23}\) Supreme Court, 7 December 2012, 03 CG.2011.93.

\(^{24}\) See BuA No. 13/2008, 140.

\(^{25}\) See BuA No. 13/2008, 140 et seq.
In practice, this means that if a foreigner establishes an irrevocable discretionary trust or a foundation in Liechtenstein (without reserving any revocation rights or equivalent powers) and chooses Liechtenstein law as the law governing the transfer of his or her assets to the foundation or trust, any claims of any compulsory heirs under the applicable inheritance law will become time-barred after the expiry of two years from the transfer of the assets to the trust or foundation.

Alternatively, a potential claim of compulsory portion will generally also be denied, if a founder makes an inter vivos donation to a Liechtenstein foundation and agrees that such contributions will be governed by a jurisdiction not having forced heirship rules at all. However, this concept has not yet been contested in court, and it seems possible that under certain circumstances a court could rule that a foundation cannot rely in good faith on such a choice of law for the transfer of assets to the foundation, if it was designed only to frustrate the rights of compulsory heirs under the applicable inheritance law.

IV WEALTH STRUCTURING AND REGULATION

The main Liechtenstein vehicles used for wealth structuring and estate planning are trusts and foundations. The following have recently been the subject of discussions or legislative efforts:

a the checks and balances that can be incorporated in the structure of a Liechtenstein foundation to prevent any abuse (often referred to as foundation governance);

b asset protection and the protection of creditors in connection with Liechtenstein trusts and foundations; and

c the use of a Liechtenstein foundation as a private trust company instead of a trustee company owned by a financial service provider.

Smart Fund

In the course of the implementation of the AIFMD in Liechtenstein, a special investment vehicle was created for families. If the investor circle only consists of members of a single family then a ‘Smart Fund’ can be set up. A Liechtenstein Smart Fund is an alternative investment fund in the meaning of the Liechtenstein AIFM Act and the AIFM Ordinance. It provides an opportunity for families to create a tax-neutral, internationally recognised investment vehicle for family members only (i.e., all family members who are or have been related by marriage or registered partnership, by direct or collateral line or by inheritance).

i Foundation governance

Foundation types

The Liechtenstein foundation is a legally and economically independent special-purpose fund, which is formed as a legal entity through a unilateral declaration of will by the founder. Assets transferred to a foundation become independent from the personal assets
of its founder. The latest reform of the Liechtenstein Foundation Law has led to remarkable amendments. In this chapter we are focusing on the area of foundation governance as one area notably affected by this reform.²⁹

For foundation governance purposes, it is necessary to distinguish between common-benefit and private-benefit foundations. For instance, a common-benefit foundation requires a registration in the Commercial Register to acquire legal capacity. By contrast, private-benefit foundations acquire legal capacity by the declaration of establishment. While a common-benefit foundation serves entirely or predominantly common-benefit purposes, a private-benefit foundation serves entirely or predominantly private or personal purposes. If this is unclear, the foundation is treated as a common-benefit foundation.

**External foundation governance**

Common-benefit foundations are subject to supervision by the foundation supervisory authority (i.e., the Office of Justice).³⁰ This authority must *ex officio* ensure that the foundation assets are managed in accordance with the purpose of the foundation. The law grants certain information rights to the authority; for example, inspection of the foundation’s books and right to information in relation to the foundation. Furthermore, the authority may apply to court to control or remove foundation bodies, to carry out special audits or to cancel resolutions of the foundation council. Such measures are available for all foundation participants,³¹ including the founder, the beneficiaries, the foundation bodies and the members of these bodies.

As a rule, private-benefit foundations are not subject to supervision by the foundation supervisory authority. This can be changed if the articles of the foundation (voluntarily) provide for supervision.

**Internal foundation governance**

All foundations that are subject to supervision by the foundation supervisory authority require an auditor. The auditor that is appointed by the court must be independent from the foundation. As foundation body, the auditor is obliged to annually review the management and the use of the foundation’s assets to ascertain that they are in conformity with the purpose of the foundation, and must report to the foundation council, as well as to the foundation supervisory authority.³²

External foundation governance of private-benefit foundations is constrained because they are not subject to supervision by the foundation supervisory authority. For this reason mechanisms of internal foundation governance, particularly the rights granted to the beneficiaries, are of paramount importance. Beneficiaries of the foundation are entitled to inspect the foundation documents as far as their rights are concerned. Beneficiaries are also entitled to information, to reporting and accounts. Again, such rights are only available if the beneficiary’s rights are affected. The law restricts the rights of the beneficiaries, for instance,

³⁰ See Article 552, Section 29 of the PGR.
³¹ See Article 552, Section 3 of the PGR.
³² Upon application, the foundation supervisory authority exempts a common-benefit foundation from the obligation to have an auditor in the case of low asset value.
in the event of abuse of such rights.\textsuperscript{33} Moreover, the rights may not be exercised in a manner conflicting with the interests of the foundation or other beneficiaries. In this respect, carefully balancing different interests is necessary. The above-mentioned rights are also restricted insofar as they can be denied for important reasons to protect the beneficiary.\textsuperscript{34}

To some extent, the interests of the founder can also be considered within the internal foundation governance: if the right of revocation has been reserved by the founder and if the founder is the ultimate beneficiary, the beneficiaries are not entitled to the information rights above.\textsuperscript{35}

Adjustments of the internal foundation governance can also result from the founder’s right to provide for other supervisory bodies. This will have the consequence that beneficiaries may only demand disclosure of information about the purpose and organisation of the foundation and with regard to their own rights in relation to the foundation, and may verify the accuracy of this information by inspecting the foundation deed, the supplementary foundation deed and the regulations.\textsuperscript{36} Obviously, this leads to restrictions for the beneficiary to get information about the foundation. In practice, the beneficiary will not be able to get the names of other beneficiaries, for example. The beneficiary will therefore also not know what distributions other beneficiaries received.\textsuperscript{37}

In summary, it can be stated that the Liechtenstein legislator has implemented various checks and balances. Because of a lack of mandatory supervision of private-benefit foundations by the foundation supervisory authority, information rights particularly granted to the beneficiaries are necessary to guarantee a control mechanism. On the other hand, the interests of the founder are also safeguarded by allowing several ways to exclude or limit the information rights of beneficiaries in certain cases.

\textbf{ii Asset protection and protection of creditors}

Asset protection and protection of creditors obviously reflect opposing interests. Needless to say, the settlor of a Liechtenstein trust or foundation seeks to protect the trust or foundation assets against third parties, but the interests of the founder or settlor are generally in conflict with the demands of third parties.

\textbf{Creditors of the founder or settlor}

Creditors may consider different options to enforce their claims towards the founder of a foundation or trust. First, creditors may dispute contributions of assets to the foundation in the same way as they would a gift.\textsuperscript{38} As a rule, every creditor having an enforceable claim is entitled to do so if full compensation could not be achieved by enforcement of the claim against the founder or settlor, or this could be assumed at the time of approval of the enforcement.

\textsuperscript{33} See Article 552, Section 9(2) of the PGR.
\textsuperscript{34} See BuA No. 13/2008, 65; Jakob, \textit{Die Liechtensteinische Stiftung}, 2009, margin No. 490; Article 552, Section 9(2) of the PGR.
\textsuperscript{35} Article 552, Section 10(1) of the PGR.
\textsuperscript{36} The founder can also be a controlling body pursuant to Article 552, Section 11(2), No. 3 of the PGR.
\textsuperscript{37} See BuA No. 13/2008, 68.
\textsuperscript{38} Article 552, Section 38(1) of the PGR. Reference is particularly made to Article 65 of the Liechtenstein Legal Remedy Code (RSO); see BuA No. 13/2008, 121.
Under Article 75 of the Legal Remedy Code, the challenge of a transfer of assets to a foundation or trust by a creditor must be possible under both the laws of the country of residence of the debtor and the law governing the transfer. As a result, if the transfer of assets to a Liechtenstein foundation or trust is made subject to Liechtenstein law, the challenge must be permissible not only under the laws of the country of residence of a foreign settlor or founder, but also under Liechtenstein law.

Under Liechtenstein law, the dispute of the transfer of assets must refer to actions made within a period of one year before approval of the enforcement. 39 The one-year period will not be required if the creditor is able to prove that the debtor’s (in the case of foundations, the founder’s) actions are based on intent to defraud creditors, in which case a five-year limitation period from the transfer of the assets applies. 40

Under exceptional circumstances creditors may refer to the general principle of the ban on abuse of legal right enshrined in Liechtenstein company law. 41

Furthermore, in the case of rights of revocation and amendment of the purpose reserved by the founder or settlor, creditors may attempt to attach such rights. 42

**Creditors of the beneficiaries**

Another instrument for asset protection is stipulated in Article 552, Section 36, Paragraph 1 of the PGR, which contains an enforcement privilege for family foundations providing that creditors of beneficiaries will not be permitted to deprive the beneficiaries of their entitlement to a beneficial interest acquired without valuable consideration by way of enforcement or bankruptcy proceedings. Such an enforcement privilege must be included in the foundation articles. 43 In the case of mixed family foundations, such a privilege can only be implemented to the extent it serves the purpose of the foundation. It is, however, questionable whether a beneficiary who simultaneously is also the founder will be entitled to such a privilege because in the case of the founder, the beneficial interest was arguably not acquired ‘without valuable consideration’ since the founder contributed the assets. 44

In practice, however, the meaning of the aforementioned enforcement restriction is limited. The reason is that it applies only if the beneficiaries have a sufficiently specified claim at all that could potentially be attached by the beneficiaries’ creditors. In the event that discretionary beneficiaries of a foundation or trust are merely members of a class of several beneficiaries without any rights to a certain share in the trust or foundation fund, there are no enforceable claims and therefore the beneficiaries’ creditors cannot attach their rights, a fact that has been confirmed by the Liechtenstein Supreme Court. 45

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39 The burden of proof will be carried by the creditor (see Article 65(2) of the RSO).
40 See Article 74(1) of the RSO.
42 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 710, providing conclusive arguments against such potential enforceability.
43 See Article 552, Section 16(2), No. 6 of the PGR.
44 See Jakob, *Die Liechtensteinische Stiftung*, 2009, margin No. 713.
45 Supreme Court, 5 February 2009, 2R EX.2008.5850-17.
V A LIECHTENSTEIN FOUNDATION AS A PRIVATE TRUST COMPANY

Many families use trusts as an estate planning vehicle and for wealth preservation. Increasingly, instead of using a trustee company owned by a financial service provider, a private trust company (PTC) is appointed as a trustee. The use of a Liechtenstein foundation as such a PTC offers several key advantages.

i A common set-up of a PTC structure

While using a PTC has several benefits, it begs the question of who should act as the shareholder of the privately held trustee company. In most cases, the shareholder cannot be the settlor of the trust because then the shares of the PTC would be part of his or her estate, which would frustrate the estate planning purpose of the trusts. A common set-up to solve this problem has been to establish a separate purpose trust whose only purpose it is to hold the shares of the PTC.

The main drawback of this approach is that again a trustee is needed for the purpose trust holding the shares of the PTC. In most cases, a trustee company owned by a financial service company is used for this purpose. This means that the reasons for not using such a company as a trustee of the family trust are still present. However, they are moved to a remoter level and are mitigated because the only assets held by the trustee company of the purpose trust are the shares in the PTC.

ii Using a Liechtenstein foundation as a PTC

Using a Liechtenstein foundation removes entirely the need for a trustee company owned by a financial service provider and at the same time reduces complexity. The structure then simply consists of a Liechtenstein foundation acting as trustee of one or more family trust.

A Liechtenstein foundation essentially is a fund endowed for a specific purpose that becomes autonomous and acquires the status of a legal person. It has no shareholders and therefore the question of who holds the foundation does not arise. Such a foundation can be established with the sole purpose to act as the trustee of one or more trusts for the benefit of a certain family.

When a Liechtenstein foundation acts as a PTC, generally no special business licence is necessary in Liechtenstein. This was clarified recently by a submission of the Liechtenstein government to the parliament dealing with an amendment of the Trustee Act. The Liechtenstein Trustee Act deals with the regulatory framework for professional trustees and trust companies. In this submission, the Liechtenstein government clarified that a PTC does not qualify as a professional trust company and does not require a licence under the Trustee Act.

The government noted that a Liechtenstein PTC, like all other Liechtenstein companies without a special business licence, requires a member of the board who is licensed as a professional trustee or in an employment relationship with such a professional trustee. According to the Liechtenstein government, no separate regulation of the entity acting as a PTC is necessary. The government pointed out that the licensing requirement only applies to ‘professional’ trustees and that a privately held trustee company typically does not meet this criterion because it is not used with the goal of creating profits. The government also mentioned that the fact of directors charging a fee to the PTC is not harmful either.

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46 See BuA 42/2013, 40 et seq.
Furthermore, the government stated that even if the Liechtenstein entity charges a trustee fee to the trusts, it still does not need to be regulated because the PTC offers its services only to a closed circle of persons. The government also specifically confirmed that a Liechtenstein foundation can act as a PTC.

VI OUTLOOK AND CONCLUSIONS

With the adoption of a tax law that is in compliance with European rules, and the revised foundation law, Liechtenstein has strengthened its position as an attractive jurisdiction for wealth structuring and estate planning.

In spite of a demanding environment, Liechtenstein maintained its high degree of stability and the financial system has proven to be very reliable during the last financial crisis. Reputation, healthy government finances and market access are the key factors for ongoing success. In this context, it is noteworthy that Liechtenstein remains one of the few European countries with a long-term credit rating of AAA by Standard & Poor’s Rating Services (Outlook: stable).
I INTRODUCTION

For decades, Luxembourg has been a major participant in the international wealth management industry with its large private banking industry. Luxembourg has also become a home for many individuals and families with significant wealth. In the past, the Luxembourg authorities have been committed to constantly improving the legal and regulatory framework, implementing instruments and vehicles designed and available for wealth management, as well as cultivating a culture of investor protection, both of which help explain Luxembourg’s success and importance. It is likely this trend has now passed as there have been no new legal instruments created in recent years to support the wealth management industry, and the draft law on the creation of a private wealth foundation, registered in June 2013 with the Luxembourg parliament, has since been frozen by the authorities.

There are many reasons that explain Luxembourg’s position in the wealth management industry and Luxembourg’s attractiveness as a country of residence, but it is primarily the political and tax stability that is key to the emergence of the industry and that at the same time continues to safeguard the necessary conditions for its permanent successful development.

Luxembourg’s public debt is among the lowest in the world (23.6 per cent in 2017; it is expected to stay stable in 2018) and it is one of the few countries in Europe to meet the 3 per cent budget deficit criteria.

The political stability and healthy public finances (Luxembourg is AAA-rated) contribute to a great extent to the social stability and the overall security in Luxembourg.

This political, social and tax stability, together with the fact that Luxembourg is part of the EU and geographically lies in the heart of Europe, is of increasing importance for wealthy families, as is the safeguard afforded by the policy of investor protection promoted by the Luxembourg authorities.

The purpose of this chapter is not to give a complete view on taxation principles for private individuals in Luxembourg but merely to address the main characteristics and issues that are important in the context of wealth management.
II  TAX

i  General
Luxembourg tax-resident individuals are generally taxed on their worldwide income. This means that all income deriving from Luxembourg or from abroad has to be included in the annual tax return of a Luxembourg resident. Non-residents are normally taxed on income generated in Luxembourg and on their property located in Luxembourg. There are exceptions to this rule under double taxation treaties and other provisions. Based on the double tax treaties signed by Luxembourg, residents will be considered as tax exempt in Luxembourg for income related to real estate located and taxable abroad, but the income that is taxable abroad will be considered for the determination of the tax rate applicable to the income to be taxed in Luxembourg.

Luxembourg has in force double taxation treaties relating to income tax with 81 countries (as of June 2018). Most provide for double taxation relief through exemption. Investment income is generally subject to tax credit rules. Most of the double taxation treaties provide for exchange of information on request following Article 26 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention. Luxembourg has not entered into any double taxation treaties relating to inheritance tax and gift tax.

By two laws of 26 March 2014 and 29 March 2013, the Luxembourg parliament adopted Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, introducing the concept of automatic exchange of information for certain information and providing for an exchange of information procedure applicable under the double taxation treaties.

The law of 18 December 2015 has introduced the Automatic Exchange of Information Law (the AEOI Law) as set forth in Directive 2014/107/EU, dated 9 December 2014 (which amends the previous Directive 2011/16/EU). The AEOI Law entered into force on 1 January 2016. As of this date, Luxembourg Reporting Financial Institutions are required to provide to the fiscal authorities of other EU Member States and jurisdictions participating in the OECD Common Reporting Standard (CRS) details of financial account information of holders who are residents of, or established in, an EU Member State and certain dependent and associated territories of EU Member States or in a jurisdiction that has introduced the CRS in its domestic law.

In application of the law of 18 December 2015, the Grand Ducal Decree of 15 March 2016 determines the list of the participating jurisdictions and the exempt products in relation to the CRS.

Unless there is a relevant double taxation treaty applicable, tax residency is determined in domestic law by two criteria: domicile or usual place of residence.

Domicile is defined as the location of the individual’s abode, in circumstances where he or she maintains and uses it (as owner, tenant, holder of a life interest, or free of charge) with a permanence that shows that he or she does not intend to stay there on a temporary basis only.

Usual place of residence is defined as the place where the individual resides, if it can be shown that he or she does not intend to stay there on a temporary basis only. The law does not fix a minimum term and, depending on the circumstances, even a stay for less than six months can qualify as a usual place of residence. A stay for more than six months automatically qualifies as a usual place of residence and the individual is considered tax-resident (the tax liability being extended to the first six months). The concept of usual place of residence is a factual one.
Double taxation treaties concluded by Luxembourg mostly follow the OECD Model Tax Convention. These provide generally that, where an individual is a resident of both contracting states, his or her status is determined as follows:

- **a** he or she is deemed resident only in the state where he or she has a permanent home available. If he or she has a permanent home in both states, he or she is deemed resident in the state that is the centre of his or her personal and economic relations (centre of vital interests);
- **b** if the centre of his or her personal and economic relations cannot be determined, or if he or she has no permanent home available in either state, he or she is deemed resident in the state in which he or she has a habitual abode;
- **c** if he or she has a habitual abode in both states, or in neither of them, he or she is deemed resident in the state of which he or she is a national; or
- **d** if he or she is a national of both states, or neither of them, the competent authorities in the contracting state will settle the question by mutual agreement.

There is no formal exit tax for individuals acting in the course of the management of their private wealth. Leaving Luxembourg does not trigger taxation on unrealised gains. However, capital gains realised on the disposal of substantial shareholdings held in Luxembourg entities after departing from Luxembourg are taxable, if the following two conditions are met:

- **a** the taxpayer was resident in Luxembourg, for tax purposes, for over 15 years; and
- **b** the taxpayer became non-resident less than five years before the disposal.

If a person resides in Luxembourg for less than six months, he or she may qualify as a non-resident (see above).

A specific regime applies to EU officials and other EU employees. If they reside in Luxembourg to perform their duties in the service of the EU, they maintain their original domicile for income tax, wealth tax and death duty purposes (Article 13, Protocol on the Privileges and Immunities of the European Union).

The official tax year runs from 1 January to 31 December. Taxpayers must file their tax returns by 31 March in the year following the relevant tax year and make quarterly advance payments. If a non-resident generates income in Luxembourg, he or she must in certain cases file an annual tax return. Final payments (or reimbursements) are made once the final tax assessment has been received from the tax administration.

Any individual is entitled to request a reimbursement of potentially excessive taxes withheld on salaries and pensions derived from Luxembourg if he or she only resides in Luxembourg for part of the year.

Since 2016, the step-up principle has been introduced into Luxembourg law: any non-resident individual who becomes a Luxembourg tax resident may revalue the purchase price of certain assets at their market value on the day that such person becomes a Luxembourg tax resident. This new regime only applies to substantial shareholdings and to convertible loans in which the taxpayer holds a substantial shareholding.

As of 1 January 2018, resident and non-resident married couples can opt for individual or joint taxation. Declared partners can be jointly taxed under certain conditions and upon request.
Luxembourg is not a tax haven and income tax rates vary from zero to 45.78 per cent (including the contribution to the unemployed fund) with the maximum marginal rate of 45.78 per cent applicable to income above €200,004 for a single person and €400,008 for a couple taxed jointly.

Income tax rates are progressive. Since 1 January 2017, the marginal tax rate is 42 per cent for taxable income exceeding €200,004 (class 1 and 1a) or €400,008 (class 2). The contribution to the unemployment fund is 7 per cent, increasing to 9 per cent for taxable income exceeding €150,000 (class 1 and 1a) or €300,000 (class 2). Therefore, the maximum marginal tax rates applicable in 2017 can amount up to 45.78 per cent. This does not include the social security and dependency contributions.

**ii  Taxation of investment income**

**Wealth tax and interest income**

For investment income purposes, Luxembourg is a very attractive country to be a resident of for the following reasons:

a wealth tax for private individuals has been abolished since 1 January 2006; and

b a final withholding tax of 20 per cent applies to interest payments made by Luxembourg paying agents to (or for the immediate benefit of) residents. This withholding tax fully discharges income tax if the beneficial owner is an individual acting in the course of the management of his or her private wealth (Law of 23 December 2005, as modified).

Residents can also opt for a final 20 per cent levy if they are the beneficial owners of interest payments from paying agents established outside Luxembourg, either:

a in a Member State of the EU or the European Economic Area; or

b in a jurisdiction that has concluded an agreement with Luxembourg in connection with the Savings Directive.

In these circumstances, the 20 per cent levy is calculated in the same way as if the paying agent was resident. The option for the 20 per cent levy must cover all interest payments made during the calendar year. Finally, residents who opt for this option must file a specific return before 31 March of the year following the year in which the interest was received.

This interest income and the assets producing the income will not need to be reported in the individual’s annual income tax return.

**Dividend income**

Dividend income is subject to income tax but a 50 per cent exemption is granted for dividends received from the following types of company (Article 115(15)a of the Luxembourg Income Tax Law):

a a fully taxable resident company;

b an EU-resident company under Article 2 of the EU Council Directive 2011/96/EU on the taxation of parent companies and subsidiaries (Parent–Subsidiary Directive); and

c a fully taxable limited company, which is:

- resident in a country that has entered into a double tax treaty with Luxembourg; and
- liable to a tax equivalent to corporate income tax in Luxembourg.

Expenses linked to such dividends are only deductible up to 50 per cent.
Currently, a withholding tax of 15 per cent (17.65 per cent if borne by the distributing company) is levied on dividends distributed by fully taxable resident companies. This tax will be credited on Luxembourg income tax or can be reduced by the application of double tax treaties or refundable under certain circumstances.

**Capital gains**

Capital gains on movable assets are taxable if:

a. they are qualified as speculative capital gains (this applies when the period between acquisition and disposal is less than six months or when the transfer precedes the acquisition);

b. they are realised on the disposal of a substantial shareholding in a resident or non-resident corporation. A resident individual owns a substantial shareholding in a company if he or she (either alone or together with his or her spouse or minor children) holds or has held (directly or indirectly) more than 10 per cent of the company’s share capital within five years preceding the disposal. A resident can also dispose of a substantial shareholding if he or she acquired free of charge, within five years preceding the disposal, a shareholding that constituted a substantial shareholding in the hands of the individual he or she acquired it from (or individuals if there were successive free transfers within the same five-year period). In these cases the capital gain will be fully taxed but at a rate amounting to 50 per cent of the average tax rate (the maximum tax rate is 22.89 per cent) and will apply a tax relief of €50,000 (€100,000 for spouses or partners jointly taxed if the capital gain is realised after a six-month holding period). These allowances can be used once per decade only;

c. no capital gains tax is due if both:
   • the gain is realised more than six months after the acquisition; and
   • the movable assets do not constitute all or part of a substantial shareholding;

d. for non-residents, capital gains on substantial shareholdings are taxable if: the shares are disposed of within six months of the acquisition or before the acquisition, which occurs, for example, when shares in a listed company are sold before their acquisition (in a regulated market that authorises such activity); or the taxpayer was resident in Luxembourg for tax purposes for more than 15 years and became non-resident less than five years before the disposal. The provisions of double tax treaties can override the rules for non-residents (double tax treaties entered into by Luxembourg generally allocate the right to tax capital gains on movable assets to the shareholder’s country of residence); and

e. a taxable capital gain is the difference between the transfer price and the acquisition price (the acquisition price includes the acquisition costs). On the transfer of a substantial shareholding, or a speculative investment, the applicable rate must be calculated. The average rate applicable to the total income is calculated according to progressive income tax rates and 50 per cent of the average rate is applied to the capital gain.

Capital gains on immovable assets, real estate and land are taxable if:

a. made within the first two years after purchase (or before purchase); and

b. made more than two years after purchase. The capital gain is subject to income tax at 50 per cent of the global rate (with a current maximum rate of 22.89 per cent) after:
   • adjustment of the acquisition price to take account of inflation during the period of ownership; and
   • application of any applicable allowance.
The same allowances that are available for movable assets apply.

For the tax years 2016 to 2018, capital gains on real estate made more than two years after purchase are subject to income tax at 25 per cent of the global rate (with a current maximum rate of 11.45 per cent) (Law of 29 June 2016).

The following additional allowances apply:

a €75,000 for capital gains realised on the disposal of real estate inherited from a direct ascendant (i.e., someone from whom a person is descended, for example, a parent or grandparent), if it was the principal residence of the taxpayer's parents (or spouse's parents);

b capital gains derived from the sale of an individual’s principal residence are exempt from income tax; and

c with a view to ensuring the sustainability of a family business, capital gains on immovable property (land or buildings) belonging to an enterprise transferred to another taxpayer who uses the assets to exploit the business would benefit from a tax deferral until the effective realisation of the assets.

Non-residents are taxed in the same manner as residents in relation to immovable assets located in Luxembourg.

Non-residents are subject to the same taxes as residents when buying assets and other property located in Luxembourg. Both residents and non-residents pay a 6 per cent transfer tax on real estate located in Luxembourg. There is a 3 per cent surcharge on real estate located in the City of Luxembourg, and a 1 per cent transcription tax.

Royalties

For non-residents, royalties that are not linked to a permanent establishment in Luxembourg owned by a non-resident taxpayer and paid to a non-resident are not subject to withholding tax in Luxembourg, nor are they taxable by assessment.

For residents, royalties are subject to Luxembourg income tax for individuals.

III SUCCESSION

i General

Luxembourg estate laws have mostly been implemented by the Napoleonic Code and are still today very similar to French estate law. For the determination of the law applicable, Luxembourg applies the last-domicile criteria for movable assets and the law of situs for real estate.


For EU residents, the situation has substantially improved since the adoption on 4 July 2012 by the European Council of Regulation (EU) No. 650/2012 on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession (the Succession Regulation).
The Succession Regulation, which does not need to be implemented into national domestic law of the Member States, entered into force on 16 August 2012 and has a direct effect on death situations occurring on and after 17 August 2015.

Under the Succession Regulation, citizens are able to choose whether the law applicable to their succession should be that of their habitual residence or that of their nationality. In the absence of a designation of the law of nationality, the law applicable to a given succession is the law of the habitual residence of the deceased.

The Succession Regulation ensures that a given succession will be treated coherently under a single law and by one single authority and that a mutual recognition of decisions relating to that succession will be implemented throughout the EU. The applicable legal system will rule the entirety of the inheritance ('principle of the unity of succession').

Regulation (EU) No. 650/2012 is not applicable:

a) to taxes and customs;

b) to the status of natural persons, and the legal capacity of natural persons; or

c) to questions relating to matrimonial law.

Luxembourg is a civil law country and as such has strong forced heirship rules. Under Luxembourg law only the children benefit from the protection of forced heirship rules. The spouse would not be a compulsory protected heir and can be excluded by virtue of a will.

Third parties or family members may only benefit from gifts or legacies if the assets fall into the scope of the free portion of the deceased. From a legal point of view, all gifts, even those executed abroad, and all contractual arrangements executed to the benefit of a third party (like insurance policies) will be reintegrated in the mass of assets as of the day of death for the purpose of the calculation of the free reserve. The same would apply to assets structured in companies, foundations and trust structures. In cases of violation of a statutory reserve, the forced heirs may claim for reduction of the gifts.

### ii Taxation of successions and gifts

Inheritance tax (IHT) is levied on the total net estate left by a Luxembourg-resident person valued on the day of the death except for:

a) real estate located abroad; and

b) movable assets located abroad and taxed abroad by virtue of the citizenship of the deceased person.

When determining whether IHT is due on the deceased’s estate, Luxembourg considers whether the deceased was domiciled in Luxembourg at the date of his or her death. This can lead to conflict with the tests of other countries, which may use the residence or citizenship of the deceased, when determining whether the estate is liable to IHT.

IHT rates vary between zero per cent and 48 per cent (including surcharge), depending on the amount transferred and the relationship between the parties.

Exemptions of IHT apply in the following cases:

a) on the portion those in the direct bloodline are entitled to under the intestacy rules;

b) succession between spouses and partners bound by a partnership agreement registered for more than three years;

c) estates not exceeding a value of €1,250; and

d) real estate situated outside Luxembourg.
The last domicile of the deceased is the decisive factor in establishing whether or not Luxembourg IHT applies.

Luxembourg levies a death transfer tax on the value of real estate located in Luxembourg held by non-residents at the date of their death. The death transfer tax rates vary between zero per cent and 48 per cent, depending on the amount transferred and the family relationship between the deceased and the heirs. Resident and non-resident heirs can be liable for death transfer tax on immovable property located in Luxembourg, if the deceased was non-resident.

Since the Law of 18 December 2009, the tax regime of estates where the deceased was a non-resident of Luxembourg has been aligned with the tax regime applicable to estates where the deceased was a resident of Luxembourg. As a result, the above exemptions and allowances apply identically in both cases.

For the determination of the taxable base, the following assets are deemed to be aggregated:

- gifts made by the deceased in the year preceding the death, unless gift tax has been paid;
- other assets received by a third party without tax pursuant to a contractual arrangement (e.g., life insurance); and
- movable goods received on real estate sold by the deceased to the heirs within three months preceding the death if the deceased has reserved a right of usufruct.

The rates of IHT are as follows:

- zero per cent on the forced heirship entitlement of those in the direct bloodline;
- zero per cent on property transferred between spouses and partners bound by a partnership agreement registered for more than three years;
- 2.5 per cent on the portion exceeding the forced heirship entitlement of those in the direct bloodline (5 per cent on the portion exceeding the freely disposable portion);
- 6 per cent on property transferred between siblings, on the portion they are entitled to under the intestacy rules (15 per cent on the surplus (i.e., the portion exceeding their entitlement under the intestacy rules));
- 9 per cent on property transferred between uncles and aunts, and nephews and nieces (and between the adopting and the adopted, in a simple adoption), on the portion they are entitled to under the intestacy rules (15 per cent on the surplus);
- 10 per cent on property transferred between great-uncles and great-aunts, and great-nephews and great-nieces (and between adopted and adopting descendants, in a simple adoption), on the portion they are entitled to under the intestacy rules (15 per cent on the surplus); and
- 15 per cent on property transferred between unrelated persons.

In addition, a progressive surcharge (from 10 per cent to 220 per cent) is levied, depending on the value of inheritance. For example, the amount of tax is increased by:

- 10 per cent for estates with a value between €10,000 and €20,000; and
- 220 per cent for estates whose value exceeds €1.75 million, bringing IHT rates to a maximum of 48 per cent.

Gift taxes are levied on the fair market value of the gift transferred. Gift tax rates vary according to the relationship between the parties. Gifts have to be passed by notarial deed according to the Civil Code and as such are subject to a gift tax. Rates vary from 1.8 per cent to 14.4 per cent.
Rates of gift tax, including the surcharge, are as follows:

- between 1.8 per cent and 2.4 per cent on gifts to those in the direct bloodline, depending on whether or not the gift is recoverable;
- 4.8 per cent on gifts between spouses and partners bound by a partnership agreement registered for more than three years;
- 6 per cent on gifts between siblings;
- 4.8 per cent on gifts made to certain public institutions, foundations and not-for-profit associations (the same rate applies in the case of inheritance);
- 8.4 per cent on gifts between uncles and aunts, and nephews and nieces;
- 9.6 per cent on gifts between great-uncles and great-aunts, and great-nephews and great-nieces; and
- 14.4 per cent on gifts between unrelated persons.

The rate is reduced by 50 per cent on gifts made under a marriage contract or with a view to marriage.

No gift tax applies on:

- tangible assets transferred by hand (unless the donor dies during the year of making the gift, in which case the gift must be included in the estate), as they are not registered;
- gifts executed by notarial deed in a foreign country. The law of the country where the gift is received (locus actum regit) governs the tax treatment of the gift; and
- gifts made to scholarship foundations designed for universities and academic public institutions (the same rate applies for inheritance) as well as, under certain conditions, some other public foundations.

### iii Legal regime

There are two types of succession: intestate and by will. In the absence of any testamentary provision, the intestacy rules apply.

The designation of the beneficiaries under the devolution rules depends upon the legal order in which these beneficiaries rank among themselves and in relation to the surviving spouse. This order is determined by: the degree of relationship; and the lineage of inheritance.

The legal devolution system provides for a hierarchy of heirs and provides for several rules (proximity, order and representation).

The hierarchy of heirs will be the following:

- the descendant (legitimate, natural, adopted);
- the surviving spouse;
- privileged ascendants and collaterals (father, mother, brother, sister and their descendants);
- ascendants other than mother and father;
- other collaterals; and
- the state.

The descendants are forced heirs. They exclude all the others, except the surviving spouse. If a child has predeceased his or her parents then the descendant of that child comes in representation of that child into the estate of the parent.

Where the surviving spouse has no children, the surviving spouse inherits all the estate and excludes all other heirs (except if divorced or excluded by application of a testamentary provision).
Where there are children present, the surviving spouse is entitled to a child portion (without being lower than a quarter of the estate) or the usufruct on the main residence.

Children receive a portion of the deceased’s estate under a forced heirship regime (Article 913, Civil Code). The amount of the forced heirship depends on the number of children:

a. one child: 50 per cent, leaving 50 per cent freely disposable;
b. two children: a third each, leaving a third freely disposable; and
c. three or more children: 75 per cent divided equally, leaving 25 per cent freely disposable.

If there are forced heirs, legacies and gifts can only be made on the freely disposable portion. When calculating the forced heirship, the following are taken into account:

a. the assets that the deceased owned at death; and
b. gifts made during the deceased’s lifetime. These are valued as at the date of the deceased’s death but taking into account their condition on the date of donation.

If the gifts granted by the deceased exceed the freely disposable portion, a forced heir who has been deprived of his or her rights can initiate an action for a reduction of these gifts. Under Luxembourg law, such a reduction must be granted. There are two types of reduction:

a. if the gift has been made to a third party who is not an heir to the estate, the reduction will be in kind, meaning that the forced heir is, in principle, entitled to claim back the gift; and
b. if the gift has been made to an heir of the estate, the reduction will be en moins prenant, meaning that the heirship will be reduced in proportion to the value of the gift received.

If the value of the gift exceeds his or her entitlement as an heir, he or she will have to compensate the forced heir in cash.

The forced heirship regime cannot be avoided by holding assets through an offshore company, a trust or foundation, or in joint names. Only the deceased’s children (and not the spouse) are forced heirs. Only forced heirs can claim for a reduction of the gift, not their creditors.

Estate planning tools, testamentary provisions, gifts, corporate structures, insurance policies, proxies, joint bank accounts, fiduciary agreements, foundations and trusts are acceptable to the extent that they do not infringe forced heirship rules.

Except for the rules applicable on forced heirship and provision applicable to the surviving spouse, the heirs cannot normally challenge the intestacy rules. However, a challenge to these rules may be possible under certain conditions.

It is not essential for the owner of assets in Luxembourg to make a will, if he or she agrees to his or her estate passing under the intestacy rules. However, an individual must make a will to take advantage of the free portion of the estate or to protect the surviving spouse’s interests.

Normally, a will set up by a Luxembourg resident would be subject to Luxembourg law. Under the EU Succession Regulation (also known as Brussels IV), discussed above, a foreign national can make a will governed by the law of his or her nationality (see Section III.i).

A will that has been validly executed abroad under a foreign law can be recognised in Luxembourg under the Hague Testamentary Dispositions Convention.

There are three forms of testamentary provisions:

a. handwritten (holographic) will (Article 970, Civil Code). This must be entirely handwritten, signed and dated by the testator;
b notary deed (Articles 971 to 975, Civil Code). This must be executed before two notaries or one notary assisted by two witnesses. Normally, a notary public takes a record of the testamentary provisions as dictated by the testator. The notary then reads the testamentary provisions to the testator and the will is signed by:
• the testator and the notaries, if the will was executed before two notaries; or
• the notary and the witnesses, if the will was executed before a notary and two witnesses; and

c mystic will (Articles 976 to 980, Civil Code). This must be handed to a notary public in a sealed envelope and the testator must declare that the envelope contains his or her last will. The will must include the testamentary provisions, written either by the testator or by someone else.

Testamentary contracts (except in marriage contracts) and inheritance agreements (pacte sur succession future), by which a person waives or grants a right in relation to assets of a future estate, are, in principle, invalid (with the following exceptions: certain provisions included in donation deeds are valid, and insurance contracts are valid).

The deceased's estate vests in the heirs on his or her death (Civil Code). The legal heirs automatically become co-owners on the death of the deceased. However, the heirs can:

a accept the estate;
b accept or refuse the estate after reviewing the estate inventory, showing its assets and liabilities (with three months to review the inventory and 40 days to accept or refuse); or
c refuse the estate.

As the heirs benefit from the rights of joint owners, they can sell their share in an asset to another heir or to a third party (Article 815, Civil Code). A person cannot be forced to stay in a joint-possession situation.

Before determining the assets and liabilities of an estate, any assets that were common to the spouses under a matrimonial regime must be liquidated.

There are two types of marital regime:

a the legal regime. This is the regime applicable if there is no marital contract. The assets and debts are owned in common (apart from those assets and debts acquired before the marriage or which are inherited or received as gifts); and

b the conventional regime entered into by notary deed. This can provide for adaptations to:
• the legal regime (e.g., by providing that assets and debts acquired before the marriage are common to both spouses or by providing for a universal community regime, meaning that all assets are owned in common between the spouses); and
• the separate ownership regime (each spouse retains sole ownership of the assets they acquired before and after entering into the marriage).

The Law of 9 July 2004 grants legal rights to cohabitants (including those of the same sex) if they declare the partnership with their local authority. This has the benefit of, for example, protection in relation to common property and tax advantages. If a declaration has been made, a partnership grants to the partners similar legal rights to those of married couples.

The surviving partners only inherit from the dead partner if a will has been made.

If the two partners are bound by a partnership of more than three years, the inheritance tax rate is zero per cent.
If the two partners are bound by a partnership of less than three years, the inheritance
tax rate is 5 per cent (for inheritance tax purposes, a lump-sum deduction of €38,000 is
applicable for the surviving partner).
The deadline for filing the IHT tax return depends on where the deceased died.

IV WEALTH STRUCTURING AND REGULATION

Luxembourg legal tools used in wealth structuring are numerous and can address almost
every need. They range from corporate structures and partnerships to contractual instruments
such as insurance policies and fiduciary agreements, and to civil law instruments such as
donations, wills and matrimonial agreements. Luxembourg has signed a large number of
HCCH conventions relating to international private law issues.

i Structuring for estate planning reasons

As a majority of estates are exempt from IHT, no advance estate planning is necessary in
most cases. For the remaining cases where IHT would be applicable, donation by hand of
cash amounts, securities or shares in Luxembourg or foreign companies, as well as insurance
policy structures, would be used. Given the fact that Luxembourg law generally invalidates
inheritance agreements by which a person waives or grants a right in relation to assets of a
future estate, structuring for succession purposes has to be used with caution.

Luxembourg has ratified the HCCH Convention on the Law Applicable to Trusts and
does not have its own trust legislation but trusts validly set up under foreign legislation can
be administered in Luxembourg and are recognised under the conditions provided for by the
Hague Trusts Convention. In that respect claims can be filed against a trustee or trust assets
in Luxembourg by a spouse, a civil partner of a settlor, beneficiary or heir.

In June 2013, the Luxembourg government adopted a draft law on the creation of a
private wealth foundation, registered and pending before the Luxembourg parliament. The
authorities have since decided to freeze this draft law and no developments are expected until
further notice.

ii Structuring for tax planning reasons

Luxembourg has no ‘controlled foreign corporation’ legislation applicable to individuals
(subject to implementation of the Anti-Tax Avoidance Directive). With appropriate
structuring, the tax impact can be anticipated on investment income, by structuring the
assets of the client in a private asset management company, by structuring substantial
shareholdings in financial holding companies or by holding a portfolio of bankable assets
through capitalising investment funds.

V OUTLOOK AND CONCLUSIONS

The Luxembourg government has committed to continue with its strategy to make
Luxembourg a major international centre in the field of wealth management.

A main international topic in 2018 remains the fight against tax fraud and the pressure
on those financial centres that are viewed as being only partially compliant or are considered to
be offshore financial centres. This is clearly not the case for Luxembourg. The recent Panama
Papers clearly highlights the importance for financial centres to be globally compliant. The
implementation of the automatic exchange of information applicable since 1 January 2016 assured Luxembourg of its place in the future landscape of the wealth management industry, as this industry, worldwide, moves towards greater transparency and private clients move to overall tax compliance. For the compliant private client it will enhance the attractiveness of Luxembourg as an internationally recognised, secure and truly compliant financial centre.

Another international topic in 2018 will be the sustainability of domestic banking secrecy laws. Along with the move to greater transparency, the role for these laws will also change, becoming of even greater importance to the private client as the gatekeeper to the private sphere and to overall security for wealthy families.
Chapter 29

MALAYSIA

*DP Naban, SM Shanmugam, Ashley Lee Si Han, Heng Jia and Christine Lay Kei Een*

I INTRODUCTION

On 10 May 2018, after Malaysia’s 14th general election, Malaysians woke up to a new Malaysia as Malaysians voted out Barisan Nasional, a political coalition that had governed Malaysia since its independence in 1957. In an equally riveting turn of events, after having already served 22 years in office from 1974 to 2004, 92-year-old Mahathir Mohamad was again sworn in as Malaysia’s Prime Minister. While Malaysians look on with anticipation as the new government begins their race against time to carry out the promises laid down in its manifesto, which includes an abolishment of the unpopular goods and services tax (GST) (having only been introduced in 2016 but argued to be responsible for rising prices) and stabilisation of petrol prices; in the meantime, amid recent revelations of staggering national debt, in Malaysia is faced with an uphill task to restore investors’ confidence.

II TAX

i Personal taxation

Malaysia’s taxation is principally governed by the Malaysian Income Tax Act 1967 (MITA). While the MITA lays out the fundamentals of personal income tax, there are other developments and case law in relation to personal income tax in Malaysia that should be taken into account in ascertaining the Malaysian taxation regime as a whole. Similar to other jurisdictions, such as Singapore, the scope of taxation in Malaysia is based on a territorial system.6

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1 DP Naban is a senior partner, SM Shanmugam is a partner, Ashley Lee Si Han is a senior associate, and Heng Jia and Christine Lay Kei Een are associates at Lee Hishammuddin Allen & Gledhill.
4 While the swift change of the GST rate from 6 per cent to zero per cent on 1 June 2018 was greeted by Malaysians with joy, the new government is tasked with introducing alternative fiscal measures to make up the shortfall from GST. In May 2018, the Ministry of Finance announced that the sales and services tax (SST), which preceded GST, will be reintroduced on 1 September 2018.
An individual in Malaysia is liable to income tax if he or she has income accruing in or derived from Malaysia (Malaysia-sourced income) or received in Malaysia from outside Malaysia (foreign-sourced income) for a year of assessment, for income in relation to banking, insurance, and sea or air transport businesses. Otherwise, all foreign-sourced income is exempt from tax.

The residence status of an individual is also an important factor in determining how an individual will be taxed, as a resident individual is taxed on both income accruing in or derived from Malaysia and foreign-sourced income, while a non-resident individual is only taxed on income accruing in or derived from Malaysia.

Pursuant to the 2016 Budget, the prime minister increased the tax rate for income earners of 600,001 ringgit to 1 million ringgit from 25 per cent to 26 per cent and for income earners of 1 million ringgit and above, from 25 per cent to 28 per cent.8

As stated earlier, the law imposes income tax on profits derived in two circumstances: Malaysia-sourced income and foreign-sourced income in relation to banking, shipping, insurance, and sea or air transport businesses. However, Malaysian law does not provide any definition of ‘income’. Nonetheless, the MITA categorises income into a number of classes.9

**Business income**

Business income includes any gains derived from a trade, profession or vocation. In ascertaining whether the gains are derived from a trade, profession or vocation, one should look at the relevant case law (including countries with taxation laws that are pari materia to Malaysia) as the MITA does not provide any statutory definitions.

**Trade**

In determining whether an individual is carrying on a trade, one should consider the following factors (commonly known as the six badges of trade):

- **the subject matter**;
- **period of ownership**;
- **frequency of transactions**;
- **supplementary work on or in connection with the asset realised to enhance marketability**;
- **organisation set up to dispose of goods**; and
- **motive for transaction.**10

**Profession**

Profession is also not defined in the Act. Case law has defined ‘profession’ to involve ‘the idea of an occupation requiring either purely intellectual skill, or if any manual skill, as in painting and sculpture, or surgery, skill controlled by the intellectual skill of the operator, as distinguished from an occupation that is substantially the production, or the sale, or arrangement for the production or sale of commodities’.11

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7 Section 7 and Schedule 1 of the Income Tax Act 1967.
10 See the Radcliff Commission final report in 1954, United Kingdom.
11 CIR v. Masse [(CA) 12 TC 41].
Vocation

This word is also not defined in the MITA. Therefore, we look to case law for guidance on its definition. For instance, the case of Partridge v. Mallandaine ((HL) 2 TC 179) held that persons who attend races, engaging themselves in systematic bets, are involved in a vocation.

An individual engaged in a business that falls under any of the above categories is subject to income tax on gains obtained thereof. Similarly, other gains arising from the running of a business, such as rental income and interest income, are also taxable.

Employment income

Employment income is any gain derived from employment. Section 2 of the MITA defines employment as any situation where the relationship of ‘master and servant’ subsists, or any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable.12

A fundamental principle of Malaysian income tax is that for income to be taxable as employment income it must be in respect of having or exercising an employment.13 The law in relation to employment income is quite clear in that one can clearly say that an individual who has a master and servant relationship or is remunerated for holding an appointment or office clearly falls under this category.

ii Gift

The Malaysian parliament has not specifically made laws to govern gifts. In general, gifts are not income and, hence, not taxable. Nonetheless, one should look at whether the gift is made voluntarily and whether it is connected to a business or employment. In short, the character of the gift would depend on the motive of the giver.14

iii Succession

There is no inheritance tax in Malaysia. Hence, property transferred by a predecessor to a successor in the context of effecting succession will not be taxed. Generally, capital gains are not taxed in Malaysia, except for gains derived from the disposal of real property or shares in a real property company (real property gains tax). Real property includes any land and any interest, option or right over such land in Malaysia.15 The rate for real property gains tax for individuals is between zero per cent (if the property is held for more than five years) and 30 per cent (if the property is disposed of within three years). For individuals who are not citizens or permanent residents,16 the rate applicable is 5 per cent (if the property is held for more than five years) and 30 per cent (if the property is disposed of within five years).17

13 McMillan v. Guest (24 TC 190).
16 See Section 2 of the Real Property Gains Tax Act 1976, on definition on ‘permanent resident’.
iv Cross-border developments

With the worldwide focus on globalisation and the fact that cross-border transactions are becoming increasingly simpler to administer, international business operations and the use of international wealth structures by wealthy families or individuals are gaining popularity. In this regard, tax implications are inevitable.

Akin to many other countries, Malaysia operates a territorial scope of taxation. The same income from a cross-border transaction may be taxed in two or more countries depending on determination of residency and permanent establishment. In this circumstance, double tax agreements (DTAs) entered into with various countries accommodate and deal with the tax conflicts.

As such, in Malaysia, when the same income has been subject to tax in two or more countries, the MITA allows the minister to declare arrangements that afford relief or credit, with the view of reducing the incidence of double taxation.18 For countries that have signed a DTA with Malaysia, taxpayers are accorded bilateral credit.19 The relief is given by way of statutory order in the Government Gazette. For countries that do not enter into a DTA, taxpayers could resort to unilateral credit.20

In this context, one frequently asked question is that in the event of conflict, does the treaty or domestic law take precedence? In general, this is very much dependent on each respective country's view on international law. In countries such as the United States, treaties have the same footing as domestic law.21 By comparison, in Malaysia, by virtue of Section 132(1)(b) of the MITA, which reads, 'not withstanding anything in any written law', these legislated words clearly give DTA precedence over domestic law.22 This principle has been well established and confirmed by Malaysian courts on several occasions.23

To further foster cross-border transactions, specific provisions have recently been enacted to provide for tax information exchange arrangements and mutual administrative assistance arrangement.24 Treaty countries would exchange information and cooperate to eliminate tax avoidance. In fact, in an effort to improve global transparency and identify the movement of global wealth, Malaysia has joined over 100 other countries in agreeing to the automatic exchange of information relating to financial accounts under the Convention on Mutual Administrative Assistance in Tax Matters.25

The Organisation for Economic Co-operation and Development also developed the Common Reporting Standards (CRS), which set out the information to be collected and reported by financial institutions of participating jurisdictions, as well as the financial account information to be exchanged, the financial institutions required to report, the different types

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19 See Paragraph 16 of Schedule 7 of the Income Tax Act 1967. Bilateral credit means credit in respect of foreign tax which, by virtue of any arrangements having effect under Section 132, is to be allowed as a credit against Malaysian tax.
of accounts and taxpayers covered, and common due diligence procedures to be followed by financial institutions. Through the operation of this legislation, the Malaysian tax authorities have set down timelines for implementation of the CRS,\textsuperscript{26} with special provisions for pre-existing individual high-value accounts.\textsuperscript{27}

The implementation of the CRS will have consequences\textsuperscript{28} that will impact more than just financial institutions. Entities, including individuals, will be required to reassess their CRS status to fully comply with the corresponding obligations and submit the supporting documents to the relevant reporting financial institutions. On top of this, certain entities, such as passive non-financial entities or investment entities managed by other financial institutions in a non-participating jurisdictions, would be required to disclose the identity of individuals who exercise control over the entity, trust or legal arrangement.

III SUCCESSION

i Introduction

Benjamin Franklin once said: ‘In this world, nothing is certain except death and taxes.’ Of the two, death, though certain, cannot be predicted as to when it will happen. It is, therefore, important to ensure that one’s estate is well planned in advance.

The law of succession is an important law that regulates the inheritance and entitlement of properties both movable and immovable and even trusts and debts in the event of death. There are three main legislations in this area – the Wills Act 1959, the Probate and Administration Act 1959 and the Distribution Act 1958. The procedural requirements in court for probate proceedings are governed by Order 71 and Order 72 of Rules of Court 2012. The law of succession is influenced by English common law,\textsuperscript{29} owing to the fact that Malaysia was a colony of the British Empire prior to its independence on 31 August 1957.

ii Key changes and applicable changes affecting personal property

The major change to the Malaysian law of succession was made in 1997, when the Distribution Act 1958 was amended\textsuperscript{30} in terms of the procedure for intestate distribution. The amendment to the Distribution Act 1958, among others, recognised equality between genders (i.e., husband and wife) and also improved the rights of parents of an intestate deceased.\textsuperscript{31}

iii Cross-border developments

Although Malaysia is part of the Association of Southeast Asian Nations (ASEAN), there has been a lack of movement to introduce cross-border law of succession between Member States similar to that done by the European Union in 2015.\textsuperscript{32}

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\textsuperscript{26} See the implementation timeline set out by the Malaysian tax authorities (http://www.hasil.gov.my/bt_goindex.php?bt_kump=6&bt_skum=2&bt_posi=1&bt_unit=2&bt_sequ=1).

\textsuperscript{27} Income Tax (Automatic Exchange of Financial Account Information) Rules 2016 (PU(A) 355/2016) defines a ‘High Value Account’ as a ‘Preexisting Individual Account with an aggregate balance or value that exceeds USD 1,000,000.00 as 30 June 2017, 31 December 2017 or 31 December of any subsequent year’.


\textsuperscript{29} Section 3 of the Civil Law Act 1956 (Revised 1972).

\textsuperscript{30} See the Distribution (Amendment) Act 1997.

\textsuperscript{31} Section 6 of the Distribution (Amendment) Act 1997.

\textsuperscript{32} See: EU Law 650/2012 (Brussels IV Regulation).
The closest resemblance to cross-border law of succession can be seen among Commonwealth Member States, of which Malaysia is a member. In cases where grants of representation are issued in the courts of competent jurisdiction in a Commonwealth Member State, the same can be resealed in courts of equal level at other Commonwealth member states or vice versa.33

As it stands, of the 10 Member States of ASEAN, only three (i.e., Malaysia, Singapore and Brunei Darussalam) are members of the Commonwealth. There is no legislation to allow the re-sealing of a Malaysian grant of representation in non-Commonwealth Member States such as Thailand, Indonesia and the Philippines. In an era of globalisation, the time has come for ASEAN countries to look into harmonising laws of succession.

IV WEALTH STRUCTURING AND REGULATION

i Common vehicles for wealth structuring

It was commonly perceived that only the wealthy would plan their wealth and finance. However, as time passed, and through education and awareness, many now realise the importance of planning their wealth and finance in advance.

The common vehicles or ‘instruments’ used in wealth, financial and estate planning are wills, codicils, trusts, foundations and charitable remainder trusts. In particular, wills and trusts are instruments that have proven effective in succession planning. High net worth individuals commonly use the combined package of trusts, foundation and charities in managing their wealth, with the goal of having their wealth to last over a few generations.

Legal treatment

Over the years, Malaysian courts have revamped and expedited the process of obtaining a grant of representation. Malaysian courts generally dispose uncontested applications for a grant of representation in under three months from the date of filing.34

There are several advantages in making a will. The main advantages are that it only takes effect after the death of the testator, hence, leaving the testator in total and complete control of his or her personal assets during his or her lifetime, and the person has control over the manner in which his or her estate is distributed after death.35 In this regard, a valid will must comply with the requirements under the Wills Act 1959. For example, a will must be in writing and signed by the testator in front of two witnesses.36 There can only be one will at any given time and the latest will revokes all former wills, codicils and testamentary documents. A will is also an effective tool to ensure that beneficiaries are sufficiently protected. For example, against trustees who may have the intention to delay distribution of assets.37

Trust instruments,38 on the other hand, bypass the need for court processes (i.e., a grant of representation) but the effect of a trust is that the settlor will have to part with his

33 Section 52 of the Probate and Administration Act 1959 (Revised 1972).
34 See Speech by the Right Honourable Tun Arifin Bin Zakaria, Chief Justice of Malaysia at the opening of the legal year 2016 at Paragraph 50.
35 As per the effect of Section 18 of the Wills Act 1959 (Revised 1988).
38 As defined in Parameshiri Devi & Anor v. Pure Life Society [1971] 1 MLJ 142.
or her assets from the time of formation of the trust, thus effectively putting him or her out of control of his or her own assets during his or her lifetime. Trust instruments also cater for very specific subject matters and may not be a viable replacement for a will in terms of testamentary disposition of assets. A trust instrument is a good supplement to a will.

Charities and foundations, while getting more popular by the day in countries such as the United States, have yet to gain any real form of traction in Malaysia. In particular, the benefits of setting up a foundation – a hybrid of a trust and a company – that is able to tap into both the benefits of trusts and the advantages of being a corporate body, have not attracted the attention of individuals in Malaysia, with the exception of those high net worth individuals as a form of asset protection and wealth management.

Though Malaysia has the necessary foundation law to offer private foundations as a vehicle for the protection of assets and estate planning, many have not seized this opportunity, perhaps because of a lack of awareness or high set-up costs. Just like wills and trusts, the public need to be educated and introduced to these two vehicles and when costs of setting up are reduced, perhaps we will see more resorting to foundations and charities for asset protection and estate planning.

Wills are, by far, the most basic instrument to fall back on for estate planning and wealth management after death.

**Tax treatment**

The principles of English trust law are instrumental in moulding the Malaysian law of trusts. Today, it is primarily governed by the Trustees Act 1949 and the Civil Law Act 1956, which still allow for the applicability of the common law of England, rules of equity and statutes of general application, subject to qualifications.

From a taxation perspective, Section 61(2) of the MITA provides that the income of the trust body of a trust shall be assessed and taxed separately from the income of a beneficiary from any source in relation to the trust. In other words, this necessitates that income tax can only be charged once, either in the hands of the trustee or the beneficiary when it is paid out to the latter.

For a trust body, any source forming part of the property of the trust, any source of a trustee of the trust, being a source of his or hers by virtue of specific provisions of the MITA and any income from any such source, save that gains arising from the realisation of investments from unit trusts, shall be treated as income of the trust body of the trust.

For a beneficiary to a trust, subject to qualifications, he or she will be subject to tax on his or her share of income. It is noted, however, that in relation to sources of income of a beneficiary to said trust, it may comprise the following:

a. ordinary source from the trust; and

b. further sources, defined under the relevant provisions as the amount of excess from the difference between statutory income from the beneficiary’s ordinary source in

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39 See the Labuan Foundations Act 2010.
40 Section 3 of the Civil Law Act 1956.
41 Section 61(2) of the Income Tax Act 1967.
relation to the trust and the total income from all sums received in Malaysia from the trust body in the basis year, together with all sums received from outside Malaysia in any year and remitted to Malaysia in the basis year.

On top of that, a trust body is regarded as resident for the basis year for a year of assessment if any trustee member of that body is resident for that basis year. In certain circumstances, the trust body in question shall not be regarded as resident in Malaysia for that basis year if:

- the trust was created outside Malaysia by a person or persons who were not citizens;
- the income of the trust body for that basis year is wholly derived from outside Malaysia;
- the trust is administered for the whole of the basis year outside Malaysia; or
- at least half of the number of the member trustees are not resident in Malaysia for the basis year.

For a beneficiary, residency status is regulated by Sections 7 and 8 of the MITA. The residence status of a trust is pertinent for the following reasons:

- a further source of a non-resident individual derived from sources outside Malaysia is exempt from income tax when remitted into Malaysia; and
- if the trust body is resident for the basis year in question:
  - the amount payable in respect of any annuity for the basis year shall be deemed to be derived from Malaysia whether or not the trust body has any total income for that year of assessment; and
  - in ascertaining the total income of the trust body for that year of assessment that amount shall be deducted in a specific manner stipulated by the relevant provisions.

In terms of tax rates, the applicable tax rate in respect of a trust body is fixed at a rate of 25 per cent for the year of assessment 2014, and 24 per cent for subsequent years. This can be contrasted with the applicable tax rate for resident individuals, which stretches across a range of zero per cent to 28 per cent, depending on the income bracket, or that of a non-resident individual, which is fixed at 28 per cent. With the comparative tax rates in mind, the setting up of trusts in Malaysia may be a viable option for private clients.

In line with Malaysia’s efforts to brand itself as an Islamic investment hub, from the year of assessment 2007 to year of assessment 2020, exemptions are accorded to resident companies in Malaysia in respect of payment of income tax for statutory income derived from a business of providing fund management services to foreign investors or to local investors in Malaysia in respect of funds managed in accordance with sharia or Islamic principles.

In Malaysia, the law governing charities is not entrenched in any specific act and instead comprises an array of Malaysian legislation, including the Companies Act 1965 and the Societies Act 1966, and case law.

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47 Section 63(3) of the Income Tax Act 1967.
50 Income Tax (Exemption) (No. 6) Order 2008 (PU (A) 255/2008).
The terms ‘charity’ or ‘charitable institution’ are not expressly defined in the MITA. Rather, Section 44(6) of the MITA accords deductions at specific rates for gifts of money made to an organisation or institution\(^{51}\) approved by the relevant authorities. This deduction is read in line with Paragraph 13, Schedule 6 of the MITA, which accords tax exemption to institutions, organisations or fund approved for the purposes of Section 44(6) or religious institutions, organisations or funds that are not operated or conducted primarily for profit and that are established in Malaysia exclusively for the purposes of religious worship or the advancement of religion. In short, an organisation, institution or fund that obtained approval from the relevant authorities under Section 44(6)\(^{52}\) will automatically\(^{53}\) be eligible for tax exemption.

On the other hand, with effect from the year of assessment 2017 and subsequent years of assessment, ‘fund’ is now defined under the MITA to mean ‘a fund administered and augmented by an institution or organisation in Malaysia for the sole purpose of carrying out the objectives for which the fund is established or held and that fund is not established or held primarily for profit’.\(^{54}\)

Further, it is noted that an approved organisation, institution or fund may also carry out businesses whereby the business is carried on in the course of the actual carrying out of the primary purpose of the institution, organisation or fund, or the work in connection with the business is mainly carried on by persons for whose benefit the institution, organisation or fund was established.\(^{55}\)

The MITA allows such an approved organisation, institution or fund to apply no more than 25 per cent of its accumulated funds as at the beginning of the basis period for the year of assessment for the carrying on of or participation in a business, provided that its profits shall be used solely for charitable purposes or for the primary purpose for which the institution, organisation or fund was established, or to carry out charitable activities outside Malaysia with the prior consent of the Minister.\(^{56}\)

It is also noted that with effect from the year of assessment 2017, a registered religious institution or organisation established in Malaysia exclusively for the purpose of religious worship or the advancement of religion and is not operated or conducted primarily for profit is exempt from payment of tax in respect of its gross income derived from all sources and is exempted from furnishing a return under Section 77 of the MITA.\(^{57}\)

While internal guidelines and rulings by the Malaysian Inland Revenue Board have no legal effect,\(^{58}\) it is worth noting that the Malaysian Inland Revenue Board issued a guideline in which it stipulated that at least 50 per cent of the income and donation received must be spent yearly in carrying out the objectives of the institution, organisation or fund, and failure to meet this condition will result in withdrawal of the exempt status.\(^{59}\)

\(^{51}\) Section 44(7) of the Income Tax Act 1967, which defines ‘institution’ and ‘organisation’ respectively.

\(^{52}\) Section 44(6) of the Income Tax Act 1967.


\(^{54}\) See Finance Act 2017.

\(^{55}\) Section 44(7B) of the Income Tax Act 1967.

\(^{56}\) Section 44(7A) of the Income Tax Act 1967.

\(^{57}\) See Income Tax (Exemption) Order 2017 (PU (A) 52/2017).


From the wording of the legislation as well as the position adopted by the Malaysian Inland Revenue Board in its Public Ruling, it appears that these businesses\textsuperscript{60} would not jeopardise the tax exemption enjoyed under Paragraph 13, Schedule 6 unless the approved organisation, institution or fund applies more than 25 per cent of its funds for the business in question,\textsuperscript{61} does not use the profits or income derived solely for charitable purposes or for the primary purpose for which the institution, organisation or fund was established, or carries out charitable activities outside Malaysia without prior consent of the Minister.\textsuperscript{62}

Therefore, the requirement for approval, as well as limitations in terms of the nature of business and the utilisation of profits derived, should very well be taken into consideration when weighing the merits of a charitable institution or organisation or fund as a wealth-structuring vehicle.

In Malaysia, the establishment of a limited liability partnership (LLP)\textsuperscript{63} is governed by the Limited Liability Partnerships Act 2012. Unlike conventional partnerships under the Partnership Act 1961, under which individual partners are subject to income tax, an LLP is treated as a separate taxable person for the purposes of the MITA. Its residence status is accorded for under Section 8(1A) of the MITA and the MITA stipulates that for an LLP\textsuperscript{64} the responsibility for carrying out all acts required to be done by or on behalf of a LLP lies jointly and severally with either the compliance officer appointed among the partners or if no such person is appointed, any one or all of the partners.

With effect from year of assessment 2017, for an LLP resident in Malaysia with a total contribution of capital (whether in cash or in kind), the chargeable income for the first 500,000 ringgit would be 18 per cent and for every ringgit exceeding 500,000, the tax rate would be 25 per cent for year of assessment 2015, and 24 per cent for subsequent years.\textsuperscript{65} It is noted that this provision does not apply if 50 per cent of the capital contribution (cash or in kind) is directly or indirectly contributed by a company, 50 per cent of the paid up capital of the ordinary shares of the company is indirectly owned by the LLP, or 50 per cent of the capital contribution and 50 per cent of the paid up capital is directly or indirectly owned by another company.

Further, subject to restrictions, a registered LLP\textsuperscript{66} is exempted from payment of income tax in respect of the amount of chargeable income derived from the carrying on of a business in the basis period for a year of assessment in respect of years of assessment 2007 and 2008.\textsuperscript{67}

It is also pertinent to note that, where a partnership or company converts to an LLP, for the year of assessment in which the conversion occurs, every partner shall continue to be personally assessable and chargeable to tax for that year of assessment and for any previous year of assessment before the conversion in like manner and to the like amount, as the company would have been taxed prior to the conversion.\textsuperscript{68}

\textsuperscript{60} Section 44(7A) of the Income Tax Act 1967.
\textsuperscript{61} See qualification at Section 44(7B) of the Income Tax Act 1967.
\textsuperscript{62} Ibid.
\textsuperscript{63} See definition under Section 3 of the Limited Liability Partnerships Act 2012.
\textsuperscript{64} Section 75B(1) of the Income Tax Act 1967.
\textsuperscript{66} Under the Limited Liability Partnership Act 2012.
\textsuperscript{67} See Income Tax (Exemption) (No. 2) Order 2017 (PU (A) 117/2017).
\textsuperscript{68} Subsections 75B(3) and (4) of the Income Tax Act 1967.
The Labuan perspective

The Federal Territory of Labuan, a federal territory of Malaysia best known as an offshore financial centre, offers attractive alternatives in its bid to attract investors. With a sound and robust regulatory framework in place, some of its key highlights are as follows.

The existence and constituents of a Labuan trust is governed by the Labuan Trusts Act 1996. Under the Act, income derived from trust property in respect of a Labuan trust is subject to the Labuan Business Activity Tax Act 1990, which imposes tax at a lower rate of 3 per cent for Labuan trading activity, or non-chargeable for non-trading activity. Alternatively, taxpayers may elect to be charged to tax 20,000 ringgit or to be charged to tax in accordance with the MITA.

It is noted, however, that the rate of 3 per cent will only be applicable to trust property that does not include Malaysian property, and generally, trust property excludes Malaysian property, unless prior consent of the authorities is obtained or the trust in question is for charitable purposes. Where the trust property in question includes Malaysian property, income from the trust property is subject to the MITA.

Further, affairs pertaining to a Labuan trust enjoy legislative protection in terms of higher levels of secrecy with strict disclosure laws, and leave from the court is necessary if any details in any court proceedings are to be divulged. Further, the accession of the CRS has also brought about recent CRS regulations enacted specifically for Labuan reporting financial institutions.

Where a Labuan trust is validly created, the courts do not vary or set it aside. In addition, the courts do not recognise the validity of any claim against the trust property in question pursuant to the laws of a foreign jurisdiction unless in specific circumstances, or if it is proven that the trust is fraudulent. The unenforceability of claims of a foreign jurisdiction may be a factor to be taken into account in considering the viability of a Labuan trust.

The accession of the Labuan Financial Services and Securities Act 2010 further establishes a more comprehensive framework in relation to private funds management in Labuan. The Act governs the requirements on an establishment of a private fund in Labuan, including the requirement for notice for private funds, as well as the appointment, duties and other aspects pertaining to private trust companies in Labuan to increase its appeal, with regard to the provision of wealth management facilities, and attract more private investors.

A recent development of Labuan legislation brings in place the Labuan Foundations Act 2010, which allows for the establishment of a Labuan foundation. The founder and

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69 Section 7(6) of the Labuan Trusts Act 1996.
70 Section 4 of the Labuan Business Activity Tax Act 1990 defines 'Labuan trading activity' and 'Labuan non-trading activity'.
71 Section 9 of the Labuan Business Activity Tax Act 1990.
72 Section 7 of the Labuan Business Activity Tax Act 1990.
73 Section 3A of the Labuan Business Activity Tax Act 1990.
74 Section 7 of the Labuan Trusts Act 1996.
75 Section 7 of the Labuan Trusts Act 1996.
76 Section 8A of the Labuan Trusts Act 1996.
78 Section 10 of the Labuan Trusts Act 1996.
79 Section 11 of the Labuan Trusts Act 1996.
80 Section 28 of the Labuan Financial Services and Securities Act 2010.
beneficiary of a Labuan foundation may be resident or non-resident. For Labuan foundations, not unlike the Labuan Trusts Act 1996, the income derived from any property which is not Malaysian property is subject to the Labuan Business Activity Tax Act 1990. Again, there are restrictions in place in relation to the property of a Labuan foundation that governs the applicable tax laws and secrecy and confidentiality provisions in place.

In addition, not unlike the Limited Liability Partnerships Act 2012, a Labuan LLP under the Labuan Limited Partnerships and Labuan Limited Liability Partnerships Act 2010 accords a separate legal personality in respect of Labuan LLPs, which is a taxable Labuan entity for tax purposes, and precludes members from personal liability save to the extent of their own investments.

ii Regulation

There may be people who abuse these vehicles, meant for genuine asset protection and estate planning, as means of laundering monies gained from illegal activities or worse, to finance acts of terrorism both locally and globally. This is more so with the ever-increasing global threat of terrorism from terrorist organisations using their ill-gotten gains to perform acts of terrorism on a global front.

It is apt that, in line with the various recommendations by the Financial Action Task Force, Malaysia has the necessary legislation in place to counter these illegal activities. Malaysia’s primary anti-money laundering regulation is the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLATFA). The AMLATFA came into operation on 15 January 2002 as a legislation to, inter alia, provide for the offence of money laundering, the measures to be taken for the prevention of money laundering and to provide for the forfeiture of property involved in or derived from money laundering, proceeds of an unlawful activity and instrumentalities of an offence, and incidental matters.

This is further supplemented by Section 114 of the MITA, which provides for the criminal offence of tax evasion – a ‘serious offence’ as defined under AMLATFA. Although AMLATFA came into operation in early 2002, it is pertinent to note that the Act is applicable to any serious offence, foreign serious offence or unlawful activity whether committed before or after the commencement date and applies to any property situated in or outside Malaysia. In other words, the Acts covers a wide range of activities and have far-reaching implications that may transcend time or territorial limitations.

81 Sections 5 and 6 of the Labuan Foundations Act 2010.
82 Section 6(3) of the Labuan Foundations Act 2010.
83 Sections 5(2) and 6(2) of the Labuan Foundations Act 2010.
84 Sections 62 to 64, 71 and 73 of the Labuan Foundations Act 2010.
88 See: Among others, FATF 2001 recommendations, FATF 2012 recommendations, FATF 40 recommendations.
89 Section 2(1) and (2) of the AMLATFA.
90 Section 4(1) of the AMLATFA.
Other anti-money laundering regulations include the Malaysian Anti-Corruption Commission Act 2009 (MACCA 2009), which established the Malaysian Anti-Corruption Commission, an independent and accountable anti-corruption body tasked with, among others, detecting and investigating any suspected offences under the MACCA 2009. With these regulations in force, Malaysia is well placed to ensure that vehicles meant for genuine asset protection, estate planning and wealth management are not used for the wrong reasons.91

V OUTLOOK AND CONCLUSIONS

The people of Malaysia look on hopefully as the new Malaysian government continues to juggle the unenviable task of fulfilling its manifesto promises, increasing transparency to weed out corruption, revamping the economy and restoring investors’ confidence. Nonetheless, the overall outlook on wealth population growth in Asia remains highly optimistic, with Malaysia’s forecast wealth population growth being one of the world’s highest.92,93 In the meantime, the number of high net worth individuals in Malaysia continues to grow at a promising rate, with an 11 per cent increase in the number of ultra-wealthy Malaysians and a projected growth of 65 per cent from 2017 to 2022.94

91 ‘Minister says Malaysia has adopted comprehensive framework that criminalises terrorism financing’ (http://www.themalaymailonline.com/malaysia/article/minister-says-malaysia-has-adopted-comprehensive-framework-that-criminalise#sthash.3hjr0aaL.dpuf).
I INTRODUCTION

Malta is an onshore high-tax jurisdiction for individuals who are both domiciled and resident in Malta. The top rate of income tax is at 35 per cent. However, British influence meant that Malta inherited the remittance basis of taxation. Under this system, non-domiciliary high net worth individuals and investors can benefit by becoming residents of Malta and being taxed only on income arising in or remitted to Malta. Capital gains arising outside of Malta even if remitted to Malta are also exempt from tax in the hands of resident permit holders.

Malta introduced a residence programme in 1988 through the adoption of the Malta Permanent Residence Scheme that was designed to attract high net worth individuals. This immediately placed Malta on the map as an attractive destination for high net worth individuals. This residence programme has evolved throughout the years into the Malta Global Residence Programme for non-EU individuals and the Malta Residence Programme for EU, EEA or Swiss individuals. These residence programmes attract, among others, retirees, authors, artists, intellectuals and international consultants, or simply persons seeking to establish an alternative residence that suits their lifestyle and tax profile. The requirements to obtain and retain residence in Malta are a minimum annual tax of €15,000 covering the main applicant and dependants on the same application, a residential address (no need to buy a property as even renting out a property is sufficient), and paying tax on a remittance basis of taxation at the advantageous tax rate of 15 per cent.

In an effort to strengthen Malta’s attractiveness for high net worth individuals, the government of Malta introduced the Malta Citizenship by Investment Programme in 2014 as the first EU-approved citizenship programme. Citizenship obtained under this programme grants the rights of full citizenship for life and can be passed on to future generations by descent. Maltese citizenship grants access to all investment opportunities in Malta and throughout the European Union, which are open to Maltese and EU citizens.

Other attractive features that make Malta popular with individuals of significant wealth, both for investment purposes and personal planning, are Malta’s geographical location (right in the centre of the Mediterranean), its climate and highly trained workforce. Malta enjoys a stable political climate and a bipartisan political scene that is largely convergent on issues of national and economic importance. Malta has weathered the financial crises well and

1 Jean-Philippe Chetcuti is the managing partner and Priscilla Mifsud Parker is a senior partner at Chetcuti Cauchi Advocates.
shared the limelight with Germany as the only two states maintaining economic growth in the eurozone. Malta’s banks have also been ranked among the top-five soundest banks in the world.

Malta has been a member of the European Union since 2004, Schengen since 2007 and the eurozone since 2008, and its economy is currently generating enticing opportunities for investors who would like to locate their interests in Malta. The country’s real gross domestic product (GDP) grew by 6.6 per cent in 2017, and this significantly contributed to the notable increase in the fiscal surplus to 3.9 per cent of GDP for 2017, following a 1 per cent increase in 2016 and government deficits in previous years. This surplus can be explained by the high growth rate of current revenue, including tax revenue and proceeds from Malta’s citizenship programme, which made a healthy contribution of 2.6 per cent to the country’s GDP. The coming years are expected to continue this positive trend in growth, despite seeing a slight ease compared to the rates registered in 2016 and 2017. Real GDP growth is forecast at 5.8 per cent and 5.1 per cent in 2018 and 2019, respectively.

Malta provides a wide range of investment vehicles available whereby wealth management is supported by legal infrastructure and regulatory framework in that various asset management solutions can be sought for private client matters whereby the system offers individuals the possibility of minimal tax leakage both on a corporate and on a personal level. This is also backed up by a strong banking infrastructure, a solid jurisprudence on foundations and a codified trusts law based on the Jersey model. Private clients are therefore spoilt for choice in terms of what vehicles to use for their wealth- and estate-planning purposes in a pleasant and safe environment with no language barriers. Maltese and English are the two main languages; however, the use of Italian, French, Spanish and German is widespread.

II TAX

Domicile and residence are the determining factors in establishing whether and in what manner a person is taxable in Malta. An individual who is resident and domiciled in Malta is taxable in Malta on a worldwide basis, that is to say on all income and capital gains wherever these are derived and whether or not these are remitted to Malta.

If a person establishes his or her residence in Malta but is not also domiciled therein, he or she would be subject to tax on a source and remittance basis and would therefore be liable to tax on:

\[ a \quad \text{income and taxable capital gains arising in Malta (e.g., on local bank interest, employment income and gains made on the transfer of immovable property situated in Malta); and} \]

\[ b \quad \text{foreign-source income that is remitted to or used in Malta (e.g., on foreign investment income paid directly into a Maltese bank account or that, although not paid directly into Malta, is eventually remitted to Malta or used to pay expenses in Malta).} \]

Capital gains arising outside Malta are exempt from tax in Malta whether or not these are remitted to or used in Malta.

The term ‘resident’ is not clearly defined in the Malta Income Tax Acts. However, there are indications in the law that may assist in determining who may be considered to be resident in Malta for tax purposes.
A person is considered tax resident in Malta by law if he or she is not a temporary resident, that is to say if he or she is not in Malta for some temporary purpose without any intent to establish his or her residence therein, and has not actually resided in Malta at one or more times for a period equal in the whole to six months in the preceding calendar year.

The income tax applicable to an individual taxpayer depends on his or her tax status. If an individual takes up ordinary residence in Malta, the progressive tax rates (zero to 35 per cent) would apply. If, on the other hand, an individual has been granted special tax status under one of the applicable programmes mentioned above, then the flat rate of taxation (15 per cent) would apply on foreign-source income that is remitted to or used in Malta, provided that the applicable requirements are complied with. The individual is required to own or rent property to be occupied as his or her principal place of residence worldwide and may not spend more than 183 days in any other single jurisdiction in any calendar year.

When purchasing a property, its value must be at least €275,000, and €220,000 when the property is in the south of Malta or Gozo. When renting a property, the values are set at €9,600 per annum for immovable property in Malta and €8,750 per annum for immovable property in Gozo or the south of Malta. Such property may not be let or sublet.

Malta tax legislation also caters for highly skilled individuals who are specifically covered by the Highly Qualified Persons Rules. Under these rules, non-domiciled individuals employed by a company operating in the financial services, gaming and aviation sectors that holds a licence or recognition by the Malta Financial Services Authority (MFSA), the Malta Gaming Authority or an air operator’s certificate respectively, receive beneficial tax treatment. The rules entitle the individuals employed in ‘eligible offices’ to apply a flat rate of taxation of 15 per cent on their employment income, which should be of at least €84,016 per annum (adjusted annually in line with the Retail Price Index), up to a maximum income of €5 million. The flat rate of tax applies for a consecutive period of five years for European Economic Area and Swiss nationals and for a consecutive period of four years for third-country nationals. Individuals who already have a qualifying contract of employment in an eligible office two years before the entry into force of the scheme may benefit from the 15 per cent tax rate for the remaining years out of the total period permitted by the scheme. As of 2018, embryologists, responsible persons and lead quality managers employed in the assisted reproductive technology sector are also eligible to benefit from these rules.

The law also provides for a flat 15 per cent tax rate in respect of employment income for eligible offices in the digital games and audiovisual industry, where such income amounts to at least €45,000. This option applies for a consecutive period of no more than three years commencing from the year preceding the first year of assessment in which that person is first liable to tax under the provisions of this law, provided that Malta Enterprise may extend the option by one year for any person whose employment commences after the 31 August of a particular year.

A similar regime, Qualified Employment in Aviation, was introduced for eligible offices in the aviation industry, with effect from year of assessment 2017. Non-domiciled individuals occupying certain posts, such as flight operations manager, aviation systems developer or key aviation specialists, earning a salary of at least €45,000, annually shall be entitled to benefit from a 15 per cent flat rate of tax on such income.
i Recent developments

The Budget Implementation Measures 2018 announced in the speech for the 2018 budget contained a number of interesting fiscal changes for individuals and businesses. These measures include the following:

a with effect from the year of assessment 2018, Maltese companies, partnerships and permanent establishments of non-resident entities may claim a ‘deduction on risk capital’, known as a national interest deduction, capped at 90 per cent of the chargeable income;

b the definition of a ‘participating holding’ has been changed: previously, one of the conditions for qualification as such holding was that a company must hold directly at least 10 per cent of the equity shares of a company. The Budget Implementation Measures 2018 reduced this threshold from 10 per cent to 5 per cent; and

c a minimum tax charge for persons ordinarily resident but not domiciled in Malta as of the year of assessment 2019 was introduced, whereby such persons are now subject to a minimum tax of €5,000 per annum regardless of the amount of foreign-source income actually remitted to Malta. This charge applies to persons subject to a remittance basis of taxation, whose annual income arising outside Malta is at least €35,000 but does not apply to those individuals who hold special tax status under any special scheme.

ii Issues relating to cross-border structuring

Double tax relief

Malta has entered into over 70 double taxation agreements and the list is always increasing. Their impact is very positive in that they encourage the growth of trade between two countries and remove the incidence of double taxation and reduce withholding taxes for payments from one country to another. The Organisation for Economic Co-operation and Development (OECD) had issued a positive peer review for the Malta tax framework in July 2013.

Before the 1994 amendments, double tax relief was only available in Malta under the domestic provisions of the Income Tax Act if the foreign tax had been suffered in a country with which Malta has a double tax treaty or in respect of British Commonwealth income tax.

Unilateral relief

Malta allows relief from double taxation on a unilateral basis where overseas tax is suffered on income received from a country with which Malta does not have a tax treaty. The overseas tax suffered is allowed as a credit against the tax chargeable in Malta on the gross amount. The credit shall not exceed the total tax liability in Malta on the receipt.

Unilateral relief for underlying tax suffered is available where the taxpayer is a Maltese company that holds more than 10 per cent of the voting power of the overseas company paying the dividend.

When claiming unilateral relief, the recipient of the income must prove the following to the satisfaction of the Commissioner:

a that the income arose from overseas;

b that the income suffered overseas tax; and

c the amount of that tax.
iii Regulatory issues relevant to high net worth individuals generally or that impact the general market of private wealth services

The tax regime applicable to the transfer of immovable property situated in Malta encompassed a combination of the 12 per cent final withholding tax regime levied on the property transfer value introduced in 2006 and in certain instances, income tax of 35 per cent (or progressive rates in the case of individuals) on the gain derived from the property transfer.

The Malta 2015 budget brought amendments to the applicable rate for the final withholding tax whereby 8 per cent instead of 12 per cent is being levied on the value of the property except in the following instances where the following different rates are applicable:

a 5 per cent of the transfer value in cases where the property being transferred does not form part of a project and the property is transferred within five years of the date of acquisition;
b 10 per cent of the transfer value in the case of properties acquired before 1 January 2004 and for which transfer a promise of sale has not been presented to the Commissioner before 17 November 2014;
c 2 per cent of the transfer value in the case of property transferred, which, immediately before the transfer was owned by an individual or two co-owners who had declared in the deed of acquisition that such property had been acquired for the purpose of establishing therein or constructing thereon his or her sole ordinary residence and the transfer is not made within three years of the date of acquisition; and
d 5 per cent of the transfer value for transfers of property situated in Valletta and other urban conservation areas outside Valletta, which were acquired before 31 December 2018 and where such property has been restored or rehabilitated and works are certified by the Malta Environment and Planning authority before 31 December 2018. Such transfer must not be made more than five years from 31 December 2018.

One should also give due regard to the fact that it will no longer be possible to opt out of the final tax system and therefore to be taxed on the profit. Furthermore, no deduction of expenses will be allowed when one seeks to arrive at the transfer value. The new implementations do not affect the exemptions that are already in place in relation to the sale of one’s own residence, donations as prescribed, assignments during separation and divorce and intra-group transfers.

iv Issues impacting entrepreneurs as holders of active business interests at the proprietor level

The implementation of the Standard for Automatic Exchange of Financial Accounting Information will surely have an impact on entrepreneurs and their businesses. The Common Reporting Standard (CRS), which was implemented as from 1 January 2016, is a multilateral agreement aimed at preventing tax evasion and fraud through the automatic exchange of information that would occur automatically once a year. The treaties empower financial authorities to monitor bank accounts (including offshore countries) whereby the banks would be required to disclose the ultimate beneficial owner even if owned via fiduciary structures.

In an effort to increase the efficiency of tax collection, the Council of the European Union adopted EU Council Directive 2014/107/EU (DAC2), which extended the cooperation between EU tax authorities’ exchange of financial accounts information. This extension effectively incorporated the CRS within EU Council Directive 2011/16/EU, particularly with regard to the administrative cooperation in the field of taxation.
Malta, as part of the early adopters group, had committed to implement the CRS in accordance to a specific time period, which led to the first automatic information exchange in September 2017.

Further, the DAC2 and CRS have been successfully incorporated into Maltese legislation by virtue of LN 384 of 2015, entitled the Cooperation with Other Jurisdiction on Tax Matters (Amendment) Regulations 2015. These regulations amend the Cooperation with Other Jurisdiction on Tax Matters Regulations, with effect from 1 January 2016.

The financial institutions that are required to report under the CRS are:

- banks and custodians;
- brokers;
- certain collective investment vehicles;
- certain insurance companies; and
- trustees, who fall under the category of custodians and will have the obligation to report accounts that are held through trusts that they administer.

### III SUCCESSION

#### i Introduction to succession

Maltese succession law, as in other civil law jurisdictions, entails the notion of forced heirship, whereby certain persons at law are entitled to receive the legitimate portion as a reserved portion calculated against the entirety of the estate of the deceased.

Chapter 16 of the Laws of Malta, the Maltese Civil Code, regulates testamentary succession and the drawing up of wills. Barring these rules on forced heirship, any person may bequeath any of his or her property in accordance with his or her discretion. In any case, a testator may bequeath by singular title, that is, as a legacy, or by universal title, that is, the person or persons appointed would succeed to the deceased in all capacities as heirs. By and large, wills are cumulative, provided that the testator does not expressly or tacitly revoke previous wills by drawing a further will in which certain clauses challenge previous ones.

With respect to intestate succession, the applicability of the rules on forced heirship holds that the persons entitled to receive in virtue of the law would be the heirs. Where the deceased has descendants and a surviving spouse, these persons are entitled to receive the inheritance; where the deceased dies without issue, the ascendants of the testator are entitled to receive the inheritance. The Civil Code further provides for those situations where there are no descendants, surviving spouse or ascendants to receive, in which case the inheritance shall devolve upon the government of Malta. These rules would also apply when no person entitled to receive accepts the inheritance; hence, no one to claim the right over the inheritance.

It is worth highlighting the fact that the civil legal approach prevails throughout the Maltese legal system and the rules on forced heirship apply even with respect to trusts and foundations. For this reason, rightful heirs may attack transactions made in relation to the trust and the foundation; namely, a settlement of property and an endowment respectively, where it may be proven that the effect thereof prejudices the entitlement of the reserved portion.

Under Maltese succession law (prevalent also in other civil law jurisdictions), persons entitled to receive by law may accept the inheritance conditionally. Strictly speaking, such persons would be accepting the inheritance through the benefit of inventory; the testamentary executor would draw up a list of all the assets and liabilities that belonged to the testator and the rightful heir would be given a peremptory time frame within which to decide whether to accept or refuse the inheritance.
Malta

ii Key legislative or case law changes affecting succession

Key changes affecting succession

The recent coming into force of Regulation (EU) No. 650/2012 of the European Parliament and of the Council of 4 July 2012 (the Succession Regulation) saw significant changes affecting succession – particularly cross-border succession – being introduced into the law. The Succession Regulation regulates jurisdiction, applicable law, recognition and enforcement of decisions, and acceptance and enforcement of authentic instruments in matters of succession. It also introduces the European Certificate of Succession. In this regard, a new chapter entitled ‘Of Cross-Border Successions’ was introduced to the Maltese Civil Code by virtue of Act No. XVI of 2015.2

New legal provisions were also enacted within the Notarial Profession and Notarial Archives Act3 governing the European Certificate of Succession.4 Amendments were also made to the Public Registry Act5 to regulate the registration within or removal of European Certificates of Succession from the Public Registry.6

Case law affecting succession

With respect to judgments delivered by Maltese law, the recurring issues are generally linked to the consent of the testator and division of property. On consent of the testator, the courts have taken a consistent approach in which invalidating a will is unequivocally the exception. Often, the court rules against the plaintiff for failing to produce sufficiently conclusive evidence that establishes the vitiation of the testator’s consent on the basis of coercion or duress. Any room for doubt has always directed the court to uphold the deceased’s will as valid on the basis that the testator’s will and intention cannot be positively challenged.

The court has also addressed matters concerning the testamentary executor who would be appointed by the deceased by virtue of his or her will for the better execution of all his or her dispositions. The testamentary executor, upon being confirmed by the Court of Voluntary Jurisdiction, is fundamentally responsible for the administration and liquidation of the estate of the testator and ensuring that the testator’s dispositions are fulfilled at law and given in full effect, while exercising any and all acts necessary for the preservation of the estate.7

iii Relevant cross-border developments

Conflict of law rules

The Civil Code contemplates situations in which wills are made outside of Malta. In these cases, a will shall have effect in Malta provided that it is made in the form prescribed by the law of the place in which the will is made.8 Having said that, the validity of any such will would have to be determined in accordance with the law the place in which the will is made.

2 Title III, Sub-Title III, Chapter VIII of the Civil Code.
3 Chapter 55 of the Laws of Malta.
4 Articles 2(1)(2)(k), and 50(1)(p) of the Notarial Profession and Notarial Archives Act.
5 Chapter 56 of the Laws of Malta.
6 Article 34A of the Public Registry Act.
8 Ibid. Article 682.
The Succession Regulation

The Succession Regulation gave rise to the need for amendments to Malta’s laws on succession. The provisions of the Regulation that have direct effect in participating EU Member States became applicable to cross-border successions from 17 August 2015, and are intended to simplify matters post-death in instances where the assets of the testator are located in more than one jurisdiction. The Regulation attempts to provide legal certainty and enable a faster and easier resolution of cross-border succession by establishing one applicable law and one court to govern the entire estate.

In this regard, cross-border succession refers to instances where the deceased held property or assets in more than one country, the deceased had his or her last habitual residence in a country other than the country of which he or she was a national, the deceased made a disposition of property upon death in a country other than the country of which he or she was a national, or the beneficiaries of the succession are habitually resident or nationals in more than one country.9

By means of the Succession Regulation, cross-border successions may be facilitated on the basis of four grounds, namely that:

- a citizen is able to choose whether the law applicable to his or her succession should be that of his or her habitual residence or that of his or her nationality. On failure to make any decision, the law of the deceased’s habitual residence would apply;
- a particular succession may be tackled under a single law and its competent authority or authorities;
- judicial proceedings and conflicting judicial decisions are avoided; and
- mutual recognition and enforcement of judgments in the EU is guaranteed.10

Essentially, the Regulation offers three possible routes to the testator:

- The Regulation introduces the principle of the last habitual residence as a default position. In this regard, the default law applicable to succession would be the law of the state where the deceased had his or her habitual residence at the time of his or her death.
- The Regulation provides an exception that in cases where circumstances are such as to show that at time of death, the deceased had a manifestly closer connection with another state, the prevailing law governing the succession will be of that state.
- The Regulation introduces an option for testators to choose to apply the law of the country of his or her nationality to regulate his or her will, either at time of making the choice or at time of death. This particular limited choice of law must be made expressly or implicitly by way of a testamentary disposition.

In practice, this would mean that any person who has Maltese nationality or has his or her habitual residence in Malta, may decide to have his or her succession regulated by Maltese law, irrespective of the fact that he or she may or will have assets in other jurisdictions, and whether the assets are movable or immovable.

The legal concept of ‘habitual residence’ introduced by virtue of the Regulation, as distinct from the concept of ‘domicile’, makes the Regulation innovative. Whereas domicile generally refers to the country intended by the individual as his or her permanent home,

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9 Article 958A of the Civil Code.
habitual residence is the place where the person ordinarily resides with a certain degree of continuity; for example, for professional or economic reasons. Interestingly, the Regulation leaves the interpretation of ‘last habitual residence’ open as it fails to provide a definition of the term. Having said this, the preamble to the Regulation stipulates that the competent authority, in Malta’s case, the Civil Court (First Hall),\(^\text{11}\) shall make an overall assessment of the circumstances of the life of the deceased during the years preceding the death and at the time of death, taking into account all relevant factual elements, in particular, the duration and regularity of the deceased’s presence in the state concerned and the conditions and the reasons for that presence.\(^\text{12}\) The habitual residence should reveal a close and stable connection.

The Regulation also recognises that determining the habitual residence of the testator may be difficult. In this regard, it provides that in cases where it is shown that the deceased maintained a closer and stable connection with the Member State of origin, in which the centre of interests of the family and social life are located, then the deceased would be considered to still have his or her habitual residence in said state of origin.

Notwithstanding the above, the substantive domestic rules on succession will remain unaltered. As a result, rules on entitlement over inheritance, property law and family law, as well as applicable tax in relation to succession, will continue to apply in any case.

**Concluding matters**

It appears that the harmonisation of certain succession matters within a cross-border context will ease many practical issues that commonly arise by reason of the diversity of rules concerning succession matters in Member States. The idea behind this is to improve the procedure as well as facilitate the liquidation of the estate through the laws of one jurisdiction based on the principle of ‘universality of succession’, resulting from the ever-growing reality of free movement of persons within the EU.

**iv Applicable changes affecting personal property**

**Matrimonial rules**

Under the Civil Code, the law regulates matrimonial regimes; establishing community of acquests as the default regime.\(^\text{13}\) However, this does not mean that spouses are obliged to establish the community of acquests throughout their marriage;\(^\text{14}\) prior to contracting marriage, the prospective spouses may opt out of this regime by means of a prenuptial agreement whereas after marriage, authorisation is required by the court prior to contracting a post-nuptial agreement. Maltese law allows spouses to choose from three matrimonial regimes: community of acquests; community of residue under separate administration; and separation of assets, also known as paraphernal property.

As regards the right to the reserved portion, whether spouses choose to opt for a community of acquests, as the most benevolent option, or for the separation of estate, such right remains an entitlement not only in favour of the deceased’s descendants but also to the surviving spouse with whom a marriage contract has been entered into. However, disposal and alienation of assets belonging to the community of acquests would be regulated by the law as

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11 Article 958C(1) of the Civil Code.
12 EU Regulation Preamble Recital No. 23 et seq.
13 Article 1316.
14 Ibid., Article 1317.
there applies such rule as requiring consent from both spouses where an act of extraordinary administration is to be carried out. By the term ‘act of extraordinary administration’ the law includes the giving of security; partitioning of property; alienation of immovable property or real rights thereon; certain donations and so on.

After the demise of one of the spouses, the right to the reserved portion applies indiscriminately whether the assets belonging to the deceased were paraphernal or co-owned with the surviving spouse.

**Civil unions**

The Civil Unions Act\(^\text{15}\) regulates civil unions and provides that, when registered, said civil unions shall for all intents and purposes have the corresponding effects and consequences in law of civil marriage contracted under the same Act.\(^\text{16}\) The law requires every person intending to contract into a civil union to fulfil all the requirements that would be necessary if one were to enter into marriage.\(^\text{17}\)

In view of the above-mentioned considerations, the law on succession does not distinguish between a civil marriage and a civil union on the basis that Chapter 530 specifically requires that the same legal effects and consequences in civil marriage apply *mutatis mutandis*.

Conclusively the legal obligations and rights emerging from the Civil Code on succession are applied without distinction in the eyes of the law as to whether the spouses are of same or opposite sex. *Inter vivos*, all of the rules with respect to extraordinary acts of administration shall be adhered to by the spouses who have contracted a civil union inasmuch as spouses who contracted a civil marriage do. Likewise, the demise of one of the partners in a civil union will *ipso jure* give rise to the same legal implications, rights and obligations as the demise of one of the spouse in a civil marriage would do. Therefore, the surviving spouse or the surviving partner is deemed to be equal in the eyes of the law in terms of their rights over the deceased's inheritance; likewise, the children thereof would benefit from the same rights irrespective of whether they are the biological children or adopted children thereof because Act XIII of 2004 has already abolished any such unequal treatment.

**IV WEALTH STRUCTURING AND REGULATION**

Malta is quickly becoming a compelling alternative in the area of wealth management thanks to the wide range of investment vehicles on offer coupled with its tax efficiency. Malta allows investors to protect their assets through the use of funds, companies, trusts and foundations in a secure EU jurisdiction that is well regulated and yet flexible at the same time, accommodating the most complex of structures. An efficient tax regime results in minimal tax leakage at both entity or structure level and the personal level. The country has an excellent legal infrastructure supported by highly qualified and experienced professionals and a track record for innovative, customised solutions. The country also has a strong banking infrastructure that can cater to all levels of wealth.

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\(^{15}\) Chapter 530 of the Laws of Malta.

\(^{16}\) Article 4(1) of the Civil Unions Act.

\(^{17}\) Ibid. Article 3(1).
Companies and partnerships
Companies and partnerships are the entities most commonly used in wealth structuring.

Trusts and foundations
Malta is unusual in that although it is a civil law jurisdiction, it caters for the setting up of both trusts and foundations. While trusts are more familiar to persons from common law jurisdictions, the concept of foundations may be more familiar to persons from civil law jurisdictions that are not familiar with the concept of a trust or have introduced it recently and therefore the concept is still in its infancy and jurisprudence minimal. Both trusts and foundations are valuable arrangements for both asset protection and succession planning.

Trusts in Malta are regulated by the Trusts and Trustees Act (the Act) that was, to a large extent, modelled on the Trust (Jersey) Law 1984. Malta has ratified the Hague Convention on Trusts and on their Recognition, and as a result, Malta distinguishes between Maltese Law Trusts that are entirely regulated by the Trusts and Trustees Act and Foreign law Trusts that may be set up and regulated by any law whatsoever and are recognised by Maltese law subject to certain conditions laid down in the Convention being satisfied.

Investment funds
Malta has become a well-established domicile for collective investment schemes. The jurisdiction is particularly well known for its well-developed hedge fund infrastructure, but Malta also caters for a number of private wealth-oriented fund structures. Growth in the sector has been very steady, bolstered by a dynamic and approachable regulator and a legal environment that provides a useful mixture of clarity and flexibility. The Professional Investor Fund has become a ‘go-to’ choice for small, relatively closely held funds that require sophisticated structural arrangements, and continues to be a popular choice even after the introduction of the new Alternative Investment Fund Managers Directive.

TAX AND REGULATORY

Companies
All companies registered in Malta are deemed to be ordinarily resident and domiciled in Malta and are thus taxable on a worldwide basis at the corporate income tax rate of 35 per cent. However, certain distributions to shareholders would entitle them to a refund of all or part of the tax paid at company level considerably lowering the effective tax rate. Income from qualifying participations may furthermore be completely exempt in Malta at the level of the company. Malta has an extensive double tax treaty network and unilateral double taxation relief mechanisms that ensure relief from double taxation in most cases.

Partnerships
Recent developments in relation to the taxation of partnerships means that all partnerships, whether en nom collective or en commandite, the capital of which is divided into shares or otherwise, may now elect to be treated as companies. Where they do not elect to be treated as companies, partnerships are tax transparent in that the partnership itself does not pay tax but the partners must include their share of partnership profits in their tax returns and pay tax accordingly at the applicable tax rates (progressive rates if partner is an individual, 35 per cent if a company).
iii Trusts
Where at least one of the trustees of a trust is tax resident in Malta, income and capital gains attributable to the trust are subject to tax in Malta. However, there are situations where legislation deems all income attributable to a trust to have been derived directly by the beneficiaries of the trust and thus insofar as no income has been attributed to the trust, no tax would be due in Malta. The criteria examined for the purposes of transparency are the nature of the trust property, source of income or gains accruing to or derived by the trust and whether beneficiaries are persons who are resident, ordinarily resident or domiciled in Malta.

iv Foundations
As a default position, foundations are treated as companies that are ordinarily resident and domiciled in Malta, thus taxable on a worldwide basis; however, the administrators of a foundation may by notice in writing to the Commissioner of Inland Revenue irrevocably elect that a foundation be treated as a trust.

v Funds
The tax treatment of funds in Malta hinges upon the classification of funds as prescribed or non-prescribed funds. A non-prescribed fund is one that holds more than 15 per cent of its assets outside of Malta and such fund is only taxed upon gains made from the disposal of immovable property in Malta. A prescribed fund on the other hand is taxed in Malta on its profits at the rate of 35 per cent.

vi Applicable anti-money laundering regime and other key aspects of regulation of service providers dealing with private wealth
Malta has distinguished itself as a serious and extremely adaptable jurisdiction in the field of private client servicing. Trustees, fiduciaries, investment service providers, funds and company services providers are among the providers that offer relevant services requiring regulation.

These service providers are regulated by the MFSA. They are obliged to comply with anti-money laundering (AML) regimes and are, therefore, supervised by the Financial Intelligence Analysis Unit (FIAU). As an EU Member State, Malta has an obligation to implement all EU directives, including those relating to AML. The most salient pieces of legislation laying out AML rules applicable in Malta are:

a Chapter 373 of the Prevention of Money Laundering Act 1994;
b Subsidiary Legislation 373.01 of the Prevention of Money Laundering and Funding of Terrorism Regulations 2008 (PMLFTR); and
c Subsidiary Legislation 373.02 of the National Coordinating Committee on Combating Money Laundering and Funding of Terrorism Regulation 2018.

All these focus on the subject of AML and funding of terrorism. The main legislative authority that obliges service providers to abide by an adequate AML regime is the PMLFTR, based on the European Parliament and Council Directive 2015/849 of 20 May 2015 (the Fourth Anti-Money Laundering Directive (4 AMLD)).

Additionally, the PMLFTR allows the FIAU to lay out rules and procedures for subject persons to abide by in their ordinary course of business, namely the implementing procedures (issued on 20 May 2011), which in turn provide a supplementary outline to the various legislative acts, clarifying the applicable regime and expanding on the following issues.
On 20 December 2017, Malta transposed into its domestic laws 4 AMLD, which introduced the obligation for EU Member States to obtain and hold in official registers accurate and current beneficial ownership information.

The Register of Beneficial Owners was introduced in Malta by way of four separate legal notices:

1. the Trusts and Trustees Act (Register of Beneficial Owners) Regulations 2017;
2. the Companies Act (Register of Beneficial Owners) Regulations 2017;
3. the Civil Code (Second Schedule) (Register of Beneficial Owners: Foundations) Regulations 2017; and

Pursuant to the above-mentioned regulations, as of 2018, Maltese legal entities (i.e., companies, partnerships, trusts, foundations and associations) are obliged to take all reasonable steps to obtain and at all times hold in an internal register adequate, accurate and up-to-date information in respect of its beneficial owners. The information collected includes, *inter alia*, the name, date of birth, nationality, country of residence and official identification document number of each beneficial owner, as well as information on the nature and extent of the beneficial interest.

This information is to be subsequently reported to respective authorities and held in the Register of Beneficial Owners, and shall be accessible to:

1. national authorities responsible for:
   - combating money laundering and terrorist financing; and
   - investigating and prosecuting money laundering;
2. the FIAU;
3. national tax authorities and any other national authorities under the PMLFTR; and
4. persons obliged under the PMLFTR to carry out customer due diligence.

Further, access to beneficial ownership information held in the Register of Beneficial Owners may also be granted to any person who, or organisation which, in a written request, satisfactorily demonstrates and justifies a legitimate interest specifically related to the prevention of money laundering and the financing of terrorism.

Malta providers bound by AML regulations are obliged to establish adequate due diligence. The norm is to undergo normal customer due diligence, comprising various obligations, such as identification and verification of beneficial owners, acquisition of dependable information about the client in general, and ascertaining the good standing of character of same.

This can be scaled down or intensified through the implementation of simplified or enhanced due diligence in accordance with the necessity of the particular circumstances of each individual client. Explicit provisions are laid down in this regard, in all the procedures identified above. Record keeping, reporting, data protection and other measures are other requirements imposed upon service providers for transactions carried out for their clients.

Another essential requirement upon service providers is that of implementing effective systems and training in observing compliance with all the rules and regulations indicated above.

was recently published by the European Parliament and entered into force on 9 July 2018. This directive amends and repeals 4 AMLD. It aims to increase transparency as to the owners of legal entities and trusts, develop particular criteria in assessing high-risk third countries, and ensure a higher level of standard safeguards for financial transactions pertaining to high-risk countries. It also proposes the requirement for the improvement of transparency on the beneficial owners of legal entities, trusts and similar legal arrangements, as well as the set-up of a national central register of bank and payment accounts and safe-deposit box holders. Member States must transpose 5 AMLD into national legislation by 10 January 2020.

VI OUTLOOK AND CONCLUSIONS

Throughout Malta’s history as a tax-efficient jurisdiction, it has acquired a reputation for being a well-regulated yet client-oriented country in which to do business. The tax regime is tried and tested and clients have the benefit of a jurisdiction with over 20 years of experience in this regard. Malta has sought to attract serious, responsible businesses and has moved away from the mere setting up of brass-plate companies to advising and implementing complex structures and transactions. Notwithstanding its successes, Malta constantly evolves and adapts to meet the needs of businesses and industries and to comply with international best practice and standards. It continues to present tax initiatives and regulatory flexibility to enhance Malta’s reputation as the jurisdiction of choice, particularly in the financial services sector, and maintains a drive to expand its already extensive double tax treaty network.

Malta has persevered through the worst of the international financial crisis, as a result of the Maltese core banks’ prudent commitment to maintaining a healthy balance sheet and robust capitalisation. The banks also fund themselves largely from the domestic retail deposit market, lend locally and hold securities issued in Malta. Growth in economic activity is being reflected in the labour market, with employment expanding and the unemployment rate declining.

This strong economic momentum should further boost employment and maintain the current low unemployment rate, which currently stands among the lowest in Europe at 3.5 per cent as of February 2018. Foreign direct investment has left its own impact on both the economy and employment, having reached a total of €165 billion in 2017. In addition, heightened activity in the services sectors has led to an intensification in exports, in the process further consolidating the country’s economy and global position. A peer review carried out by the OECD found Malta to be fully compliant with the international transparency standards and exchange of information requirements for tax purposes. The Maltese authorities have taken a series of steps to deliver a fair tax system by fighting tax fraud, evasion and avoidance and are likely to follow the lead taken by the OECD and EU in this regard, particularly with reference to the Base Erosion and Profit Shifting project. Malta continues to comply with OECD standards and has joined the group of ‘early adopters’ of the OECD CRS.

There is no indication of taxes on wealth or property being introduced at this stage.
INTRODUCTION

In recent decades, Mexico has experienced improved growth in trade, investments and productivity and, as a member of the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization, has become a champion of free trade, with a considerable network of tax treaties, which has given rise to a large amount of wealth being created. Unfortunately, however, this wealth is amassed in a small percentage of the population. The country has one of the highest rates of inequality in the world and certainly faces challenges in the future to achieving inclusive and sustained growth for all its citizens.

Over the past 18 months, certain events have created both opportunities and obstacles with regard to private investments in Mexico, such as the renegotiation of the North America Free Trade Agreement (NAFTA), the US tax reform and this year’s presidential election, which culminated in a landslide victory for Andrés Manuel López Obrador, whose new administration will take power in December 2018.

Further, in 2017, Mexico registered 11.1 per cent more foreign direct investment (FDI) than the preliminary figure for the same period for 2016, and from January to March 2018, registered 19.1 per cent more for FDI – higher than the preliminary figure for the same period of 2017. This demonstrates that foreign investors are increasingly interested in Mexican business, mostly in the manufacturing sector. Moreover, the Mexican economy is expected to grow by approximately 2 per cent in 2018 and by over 2 per cent in 2019.

With respect to NAFTA, as of late March 2018, seven rounds of negotiations have taken place and more than 30 issues are being discussed. Nonetheless, the current dynamic of the negotiating positions may still drive the negotiations towards a breakdown with respect to increasing requirements for regional and country-specific rules of origin; expanding national preferences in government procurement; weakening investor-state dispute settlements, trade remedies and dispute resolution regimes; and, perhaps most importantly, subjecting the agreement itself to a mandatory periodic sunset provision in the absence of new negotiations. The potential changes to and repeal of NAFTA would have far-reaching effects with regard to Mexico’s future investments.

Another development with significant implications in Mexico is the US tax reform, approved on December 2017, which reduces business tax rates and substantially modifies

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1 Edgar Klee Müdespacher is a partner and Joel González Lopez is an associate at Haynes and Boone, SC.
2 FDI for 2016 (US$26,738.6 million). FDI for 2017 (US$29,695 million).
3 FDI for January to March 2018 (US$9,502.4 million). Same period for 2017 (US$7,945.6 million).
4 35.2 per cent of the FDI in 2018 came from the manufacturing sector.
the US international tax system. As a result, the reforms will have important consequences for companies and markets in Mexico, including the taxation of US corporations’ foreign subsidiaries.

Another relevant aspect that all investors must consider in the global tax environment is the undergoing legal modifications that were triggered by the Base Erosion and Profit Shifting (BEPS) Action Plan set forth by the OECD. BEPS actions are focused on information transparency and avoid the undue use of treaties, which reflects a minimum standard to combat ‘treaty shopping’.

As a member of the OECD, Mexico has been actively involved in the design and development of BEPS, and began implementing many of the following recommended actions in 2014:

a. anti-hybrid rules (Action 2);

b. a form of mandatory disclosure requirement for taxpayers (Form 76) (Action 12);

c. an obligation for taxpayers to present a country-by-country report, master file and local file (Action 13); and

d. new OECD Transfer Pricing Guidelines (Actions 8–10).

Mexico is a signatory party to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, under which Mexico elected to supplement the principal purpose test with a simplified limitation on benefits provision.

Further, Mexico has broadened the scope of exchange of tax information under the Common Reporting Standard (CRS), with currently 90 active automatic exchanges relationships with other countries, as well as the Foreign Account Tax Compliance Act with the United States.

Related to the above, it is also worth mentioning that in 2017 Mexico attracted nearly 345.447 billion Mexican pesos in investments into the country through a tax repatriation plan. The repatriation programme was applicable to capital and resources held abroad either directly or indirectly by Mexican taxpayers. In the near future, we expect certain transactions carried out through this repatriation programme to be audited by the Mexican tax authorities, such as those where the repatriated funds were used to increase equity in a Mexican entity and the entity dispersed abroad.

Finally, on 1 July 2018, the presidential elections in Mexico took place. It is important to emphasise that this election was of great significance, since it will bring about a change of administration. The new administration will bring changes to various areas of the Mexican economy, which may bring new business opportunities for investors, but also new rules that will have to be reviewed to better capitalise on the opportunities in the new political environment. The principal proposals with regard to fiscal policy comprise a boost in public investments and social programmes, a federal austerity programme, tax cuts and increased spending on public projects, and reducing income and payroll taxes. Many of these proposals would need to increase federal revenues and the federal government’s budget.

II TAX

Mexico has a residence-based system under which, if an individual resides in Mexico for tax purposes, he or she is subject to taxation over his or her worldwide income. An individual is a Mexican tax resident if he or she settles his or her habitual abode in Mexico. If an
individual has a home in Mexico and another country, the centre of vital interests is the factor that determines the tax residence in Mexico. Mexican nationals are presumed tax resident in Mexico.

Income tax liability is the income obtained by the taxpayer during a fiscal year (which coincides with the annual calendar). Mexican law does not provide a general definition of ‘income’; however, in the context of the Income Tax Law, Mexican courts have defined it as a ‘positive modification registered in the patrimony of a person that is susceptible of pecuniary valuation’. Individuals are taxed on income received in cash, in kind, in credit or in services.

Individuals can apply certain personal deductions (education costs, charity donations, medical and dental) and most personal deductions are limited to 15 per cent of the yearly taxable income.

Personal income tax rates are progressive up to 35 per cent. Individuals with business activities or professional income are subject to income tax at the rate of 30 per cent and may deduct normal business expenses according to entities rules. In most cases, a tax return has to be filed by the end of April in the following year.

Non-resident individuals are taxed only with respect to income sourced in Mexico with varying terms and conditions depending on the type of income. The tax rate varies between 5 per cent and 40 per cent. Double taxation agreements apply by reducing the taxable rates or even producing a non-taxable event.

The principal type of taxable income for individuals (residents in Mexico and non-residents) are the following.

i Sale of shares

Mexican-resident individuals are taxed over the sale of goods, including shares issued by foreign entities. To assert the tax base, individuals are allowed to perform certain deductions. For such purposes, Mexican-resident taxpayers will be able to deduct, among others, the updated amount of the acquisition cost of the shares, commissions and certain considerations paid to intermediaries, and some other taxes or duties paid.

With respect to foreign individuals, the sale of the shares will trigger a tax of 25 per cent on the net income, or 35 per cent on the gross amount, if the non-resident appoints a representative in Mexico. A tax return must be filed in conjunction with an auditor’s opinion obtained from a Mexican public accountant certifying that the reported gain was correctly determined.

Income deriving from the sale of securities or publicly traded shares is subject to a 10 per cent tax on the gain (foreigners are subject to a 10 per cent withholding tax on the gain).

ii Dividend distributions

Resident individuals must include the dividends received from Mexican corporations (grossed-up for the corporate income tax paid by the corporation) in their individual income tax returns and are able to claim the underlying corporate income tax paid as a credit against their personal tax liability.

Moreover, with respect to dividends paid from profits that were generated by the distributing entity after 2013, an additional 10 per cent tax on the net dividend will be withheld by the Mexican company. This tax is in addition to the tax paid with the annual tax return, and it cannot be credited. In the case of dividends paid to foreigners, the dividend amount will also be subject to this 10 per cent withholding rate.
Double taxation agreements, in certain cases, grant preferential withholding rates upon any profit or dividend distribution sourced in Mexico (reducing it by up to 5 per cent).

*** Interest income
Interest earned in accounts held in Mexican banks is subject to withholding tax and should be reported in the annual tax return.

Interest on bank accounts, bonds and other debt obligations issued by non-residents is fully taxable, and the taxable interest includes adjustments for inflationary losses and exchange gains and losses with respect to the principal.

Interest paid to a non-resident is subject to withholding tax at rates ranging from 4.9 per cent to 35 per cent and 40 per cent.

iv Real estate
Income deriving from the sale of real estate is taxable for income tax purposes considering the seller’s gains (tax basis with recognition of the inflationary effect).

With respect to the acquirer, a local tax of approximately 2 to 6 per cent is applicable on the commercial or transaction value (whichever is greater).

If the real property is acquired as a gift or at under 10 per cent of the appraisal value, income tax will also be triggered by the acquirer.

With respect to foreign individuals, the sale of the real estate will trigger a tax of 25 per cent on the net income or 35 per cent on the gross amount if the non-resident appoints a representative in Mexico.

v Inheritance and gift taxes
There is no specific inheritance, estate or gift tax in Mexico. Inheritance and gifts are treated as income under the income tax law, but they may be exempted as long as certain requisites are complied with.

Income received by Mexican tax resident individuals from inheritance and donations (when applicable) in a given tax year, must be reported to the tax authorities in their annual tax return. Income received by resident individuals from donations shall be reported to the tax authorities when all donations (including prizes and loans) received in a tax year exceed 600,000 Mexican pesos.

Income received as a result of a gift from a spouse, lineal ancestors or lineal descendants is also exempt. However, gifts between siblings are not exempt, and gifts to parents are not exempt if the asset is later given or sold to a sibling of the original owner.

Other gifts are tax exempt, provided the gift does not exceed 88,209 pesos. Any portion of the gift exceeding this amount would be subject to income tax.

vi Taxpayers subject to the preferential tax regime
Mexican tax residents will be subject to the preferential tax regime rules regarding income generated directly or indirectly through foreign legal entities or figures, including those considered transparent (i.e., flow-through for tax purposes), in which they participate directly or indirectly, in the proportion of their participation in the capital of such legal entities or figures.
Income subject to the preferential tax regime is subject to taxation in Mexico in the fiscal year that such income is generated abroad, even if the income, dividends or profits have not yet been distributed by the entity or figure in which the Mexican taxpayer directly or indirectly participates.

Taxpayers must file in February of each fiscal year an informative tax return regarding income subject to the preferential tax regime directly or indirectly; income generated in the previous tax year; income generated in blacklisted countries; and transactions carried out through tax-transparent foreign legal entities or figures.

There are several exceptions to this regime, especially regarding the absence of effective control on the foreign legal entity or legal figure. See Section IV.

III SUCCESSION

Succession is a part of civil law that, for purposes of Mexican legislation, is regulated in the federal and local civil codes. Mexico has 32 federal states or entities, including the capital, Mexico City. The federal and local civil codes have mostly the same regulations but there may be specific conditions that differ among them.

The Federal Constitution establishes that the powers not expressly granted to the Federation are understood to be reserved to the states. Therefore, since succession is not a federal matter, depending on the state where the succession takes place, their local civil code will be the applicable one.

The transfer of an estate could take place by operation of a will (which will determine to whom and how the decedent patrimony will be divided) or in the absence of a will, through a set of specific rules contained in the local state-applicable civil code, which will determine who is entitled to receive assets and how the assets of the successor will be transferred. In an intestate succession, the descendants, ascendants, collateral relatives, spouses and concubines have the right to inherit. Heirs can resign their inheritance rights. The probate process in Mexico is carried out before a Mexican notary or a judge. Further, there are specific non-probate rules for certain assets, such as bank accounts with a beneficiary.

The administration of an estate of inheritance commences with the death of the decedent according to the testament given before a notary public, as an intestate or legitimate succession when there is no testament, or where the testament that was granted is invalid; the testator did not dispose of all the assets; or there is no heir (because of death, repudiation or a condition that is not fulfilled).

5 Currently, most states allow same-sex marriages (including Mexico City). The Supreme Court declared, in a binding precedent, that the state laws that prohibit marriage between persons of the same sex are unconstitutional for being discriminatory. Therefore, in all the states of Mexico, same-sex marriages could be carried out. On the other hand, for unmarried couples that have lived together in a constant and permanent way for a minimum period of two years or have a child in common, there is a special figure named concubinage. These couples have the right to reciprocally inherit from one another as if they were spouses (in the event of an intestate succession). The Supreme Court declared, in non-binding precedents, that the concubinage is considered for same or different sex couples in accordance with the same reasons that allow the same-sex marriage (non-discriminatory principles).

6 On 23 July 2012, the last significant amendment made to the Mexico City's Civil Code relating to succession was published, in which the different types of testaments that could be granted were eliminated (public, private, hand written, military and maritime), with the only one remaining as valid being that made before a notary public.
Upon the death of the successor, the administration of the estate will be managed by an executor, who is appointed by the decedent in its will or named by a majority of the heirs if there is an intestate procedure. An heir could also be designed or appointed as executor. The executor needs to accept his or her duty or resign. The executor will perform an inventory of the assets, pay debtors of the estate and proceed with a partition and distribution of the assets.

A will made in a foreign country could have legal effects in Mexico City or other states when made according to the laws of the country in which it was granted and if it is not considered invalid under Mexican legislation.

A foreign person may inherit in Mexico. In this scenario, the inheritor must comply with certain Mexican rules. In this regard, generally, foreigners can acquire real estate (including through inheritance) in Mexico if they agree to consider themselves as nationals with respect to said property and not to invoke the protection of their governments.

In relation to the above, the Mexican Foreign Investment Law regulates how and in which cases foreigners can acquire real estate. Foreigners, individuals and legal entities can acquire real estate if they are located outside a restricted zone (100 kilometres from borders and 50 kilometres from beaches). There are special requirements that must be fulfilled. The acquisition of other kinds of assets besides real estate and shares is not prohibited or restricted.

With respect to prenuptial agreements and their effects on personal property and transfer of such under a will or intestate succession, a couple may enter into a prenuptial agreement before the wedding to constitute the patrimonial regime of their marriage (joint property, separated property or a mixed regime) and to regulate the administration of the assets. However, this agreement does not grant inheritance rights and it is not commonly executed.

As for the tax effects that derive from a succession, these can generally be divided between those applicable to the estate before it is divided and awarded to the corresponding heirs, and those applicable for the acquisition of the assets.

The executor will be the one responsible (being also jointly liable) for the calculation of the taxes generated under the estate probation and filing of the tax returns.

Currently, there is no inheritance tax applicable in Mexico. For income tax purposes, any transmission of assets made via a succession is exempt so long as the acquisition is reported in the annual tax return corresponding to the year when the assets are adjudicated to the heir. Life insurance payments are tax free if the insurance company is a Mexican insurer. There is a carry-over basis where the heir will also ‘inherit’ the tax basis of the transferor (normally the cost of acquisition).

In recent years, there have been certain proposals for enacting changes to the tax laws to create an inheritance tax. Although such proposals were rejected in the Mexican Congress, recently the OECD recommended that Mexico adopts a tax on inheritances,7 a recommendation that might be picked up by the new administration when it enters into office in December 2018, and may be part of a near-future tax-reform proposal.

The acquisition via a succession of real estate is taxed with a local tax that ranges from 2 per cent to 6 per cent and the basis for the tax is normally considered to be the appraisal value of the asset to be transferred.

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Foreigners acquiring real estate or shares of Mexican entities will also be taxed at the rate of 25 per cent on the fair market value (appraisal) without being able to credit or deduct a cost basis.

IV WEALTH STRUCTURING AND REGULATION

Investments made by Mexican tax residents in Mexican structures

One of the most common structures is the use of a fideicomiso (a Mexican trust), which is a commercial agreement governed by Mexico’s general law of credit instruments and operations.

A Mexican trust normally consists of three parties: the trustor or settlor, the trustee and the beneficiary, although the beneficiary is not required in some trusts. The trustor or settlor can either be an individual or an entity and is the party that usually transfers title or management of certain assets, rights and benefits to the trustee, who holds them in the trust.

The trustee is the party who holds the assets in the trust, and the party that is given the responsibility of performing and complying with the specific purposes and goals of the trust. The beneficiary, although often named, is not a party that appears in all trusts. The beneficiary of the trust is the party that stands to benefit from the assets and trust, whether by using and enjoying the assets, by having privileges or special rights to the assets, such as a security interest, or by receiving income from the assets.

The trustee must always be a Mexican bank or financial entity, and it must act in accordance with the trust’s purpose.

Mexican trusts are always created for specific purposes, and trustees are bound and limited to act in accordance with such purposes. However, in practice, trustees usually take a passive role during most of the trust’s life, further allowing management and other duties to be taken by the beneficiary or other third parties.

By law, trusts are considered irrevocable, unless otherwise provided in the trust itself, and also by law, trusts can also hold most types of properties and rights.

When properties and rights are transferred to the trust, the trustor may ‘hold back’ or ‘reserve’ for itself, certain portions of a particular asset, or only do so under a partial or limited assignment. This means the trustor may also keep and maintain for himself or herself, certain rights over the assets held in trust.

Trusts must be in writing and prepared (or amended) following the same formalities required for the transfer of the properties that will be subject to the trust. For instance, if the property to be transferred to the trust is real property, then the trust must be created with the same requirements as when real property is transferred in Mexico. That includes the formalisation of the trust in a public deed in front of a Mexican notary public.

Trusts are normally created for a specific period of time and cannot exceed 50 years, except under certain specific cases where this term may be exceeded.

The trust can be framed under two different fiscal effects, depending on the operation carried out in the trust: if the assets affected by the trust are transferred in ownership, all the effects inherent to property transfer would be presented; however, if the patrimony affected by the trust is commercial activities, the effects inherent to the performance of business activities would be presented.

No sale is deemed for tax purposes when asset contributions are made to a trust and the settlor reserves the right to reacquire such assets. The income tax is triggered when such reacquisition right is lost or when a third party is the beneficiary of the trust.

The property transfer tax is triggered in real estate transactions in Mexico.
If the Mexican trust carries out commercial activities (receiving active income, namely income from sales) it will be considered as an entrepreneurial trust for Mexican tax purposes. In this scenario, the Mexican trust will determine the taxable profit and such will be allocated to the beneficiaries. Losses are not allocated to the beneficiaries (they remain in the trust and can be offset only against profits derived from the trust activities).

**ii  Insurance as an investment vehicle**

Other forms of wealth structuring have included the usage of insurances (survival or with some savings component) on a stand-alone basis or combined with other structures (such as foreign trusts).

Payments obtained by Mexican tax residents derived from insurance agreements could be considered as tax-exempt income as long as the following requirements are fulfilled:

- **a** Survival insurance: when the risk covered by the insurance is the survival of the insured person, the payments will be considered tax-exempt income provided they are paid when the insured person reaches 65 years of age and at least five years have passed since the insurance was contracted.

- **b** Life insurance paid by individual: if life insurance was not paid directly by the employer for its employees, the payments will be considered tax-exempt income as long as the risk covered is the death, disability, loss of limb or incapability of the insured individual to perform a remunerated personal job in terms of social welfare provisions.

- **c** Retirement and healthcare insurance: payments derived from departure, pension or retirement insurance, as well as healthcare expense insurance, may be considered as partially tax exempt as long as certain specific requirement are met.

The aforementioned exemptions are only applicable if the amounts are paid by an insurance company that is incorporated in terms of Mexican law; payments or income obtained from foreign insurers are not considered exempted.

**iii  Investments made by Mexican tax residents in foreign structures**

It is customary for Mexican individuals to set up structures abroad using certain types of entities or legal figures for inheritance, confidential and tax-deferral purposes.

In these cases, Mexican tax residents could be targeted with certain anti-deferral tax rules (a preferential tax regime) when they generate income directly or indirectly through foreign legal figures (such as a trust) or entities (such as limited liability companies) and as long as said income is not taxed abroad or the income is not effectively taxed by at least 75 per cent of the Mexican tax rate. For such purposes, this special regime considers as income all passive income (including certain types of services, charters, etc.).

Income obtained directly or indirectly through transparent foreign legal entities or legal figures would also trigger this special regime.

For these purposes, a legal figure or entity is consider to be transparent when two conditions are met: when it is not considered as a taxpayer in the country in which it is incorporated or in which its main administration is established; and when its income is attributed to its members, partners, shareholders or beneficiaries.

The consequence of being targeted with this special regime is that the income generated in the investment vehicle is subject to taxation in Mexico in the tax year in which it is generated; the income is taxable irrespective of whether it is received by the Mexican individual as it is the anticipation of an accrual.
There are certain exceptions to this special regime, and the one that is most commonly encountered within this type of structure is the lack of control over the vehicle or over its management such that the Mexican investor cannot decide when the income, profits or dividends are to be paid out.

It is important to note that the Mexican investor is considered, by operation of law, to have control over the investment vehicle; therefore, the individual has the burden of proof and will be required to gather and maintain sufficient evidence to demonstrate that no control exists.

Similarly, Mexican taxpayers must file an informative tax return with the Mexican tax authorities regarding:

- income that is subject to the aforementioned special regime;
- income generated in countries listed under the Mexican Income Tax Law, which are considered to be tax havens (blacklisted territories); and
- transactions carried out through foreign transparent tax structures or entities.

With respect to the tax return described in (a), this obligation is not present where the taxpayer does not have effective control of the vehicle or the vehicle's management, which includes the authority to control the timing of distribution of income, profits or dividends, whether directly or through third parties.

With respect to the informative return mentioned in (c) (transactions carried out through foreign transparent tax legal structures or entities), this obligation was not historically present in those cases where the foreign transparent tax structure was created in a country which Mexico had an ample exchange-of-information mechanism. However, this exception was contained in a certain administrative rule that was eliminated on 14 August 2016.

From the above, the inclusion of certain transparent entities or figures (such as some trusts) will trigger the obligation to report the structure even if there is no control over the moment or timing to distribute income. Thus, a careful review should take place for any structure that has these types of entities or figures.

If there is a noncompliance with the filing of the above-described informative returns, this may be considered a tax crime.

### iv Investments made in Mexico by foreign investors

Wealth tax structures for foreigners would vary depending on the type of investment and also how the individuals have accommodated their structure abroad. Normally, it is common to have investments that derive interest, dividends, capital gains and real estate, of which tax effects are discussed in Section IV.iii.

Nevertheless, it is worth mentioning that several foreign structures put into place in Mexico with respect to private capital (normally related to investments in real estate) is the usage of transparent figures, which are considered for Mexican tax purposes as flow-through entities. It is customary to encounter the usage of partnership agreements (generally from provinces in Canada).

As mentioned, for Mexican tax purposes, the partnership will be viewed as a transparent figure, and all the income received from a Mexican taxable source will be considered received by the members of the partnership, even granting, in the case of foreigners, the benefits of double taxation conventions (if the member of the partnership qualifies).
This transparency treatment is recognised owing to civil law recognition of the non-legal separate personality of the partnership from its members, irrespective of the tax treatment in the country of origin or creation of the partnership. Unfortunately, this eliminates structuring using entities that have a separate legal personality.

v Anti-money laundering and other applicable regulations

The anti-money laundering regime is fairly new in Mexico, having been introduced in 2014; however, despite this, the financial sector and others who have been especially vulnerable to the negative effects of money laundering have strongly supported its implementation.

Mexican anti-money laundering operates through a legal system that forces financial institutions and persons involved in vulnerable transactions to identify and monitor their clients to prevent, detect and report money laundering (specific transactions include real estate acquisitions, loans not granted by the banking system, lending of real estate, acquisition of jewellery, gambling and other customary activities that are identified with money laundering).

On 14 June 2018, a Decree was published in the Federal Official Gazette that reforms the General Corporations Law. The Decree will enter into force on 15 December 2018. The amendment imposes on limited liability companies and business corporations the obligation to inform the Ministry of Economy of any change in the structure of their capital stock. These reforms promote the report and exchange of information between authorities with the purpose of fighting against money laundering by taxpayers.

These changes will have an effect in terms of the enforcement of the Anti-Money Laundering Law (Federal Law for the Prevention and Identification of Operations with Illegal Assets), since, through the aforementioned report and exchange of information, authorities may now verify the accuracy of the data collected to see if any vulnerable activity is being carried out.

Also, in recent months, tax authorities (which are the authorities with the power to review and impose penalties related to the compliance of anti-money laundering regulations) have been issuing fines to a considerable number of individuals and corporations who did not identify clients who carried out vulnerable activities or who did not present the corresponding information required by the Anti-Money Laundering Law.

V OUTLOOK AND CONCLUSIONS

The current investment and wealth management climate cannot be disassociated from international efforts towards transparency and avoidance of double non-taxation agreements and implemented mainly and, among others, by the OECD with its BEPS project and the CRS platform.

Today, the automatic exchange of information is a reality that the tax authorities around the world have embraced. This situation implies that wealth structuring cannot rely on having the objective of ‘catch me if you can’ or secrecy. It is required to be fully compliant with the tax laws of multiple jurisdictions, to pass the test of substance and also to be aware that a high number of compliance or informative returns (not just tax returns) must be taken into account. The wealth management world has changed.

Mexico has been a part of this change and it is likely that there will be a higher focus on reviewing wealth structuring by the Mexican tax authorities. Tax enforcement will be facilitated through collaboration with other countries, and the amount of information that
the Mexican tax authorities might have about a particular individual or transaction will be remarkable. Structures that in the past were non-compliant where they relied purely on confidentiality will be tackled and fought by the tax authorities with all the new tools available.

These changes have led, in some part, to the high amount of revenue collected by the 2017 repatriation programme, successfully implemented by the Mexican tax authorities. Even now, some audits are beginning to review whether the compliance of the requisites set forth in such programme were observed by the taxpayer. Also, certain public leaks related to investments in locations regarded as secret offshore tax havens have piled pressure on the tax authorities to increment their reviews on Mexican high net worth individuals on compliance and the need to increment public awareness about compliance, as well as the possibility of voluntary disclosure and regularisation. Further, the outcome of the NAFTA renegotiations and understanding the international effects of the US tax reform may also have repercussions with regard to current structures of high net worth individuals.

Finally, the most profound element of change will come about through the new administration, which will take office in December 2018. This new presidency, with potential control over both the House of Representatives and the Senate, could with further alliances gain the power to amend the Constitution, implementing programmes that will increase social spending, which will have to be funded in some part through an increase of tax revenues.

From the above, we can expect, in the future, a larger amount of tax enforcement actions, rather than a change of tax policies or modifications to the current tax legal framework. This is a situation to take into account, whether with the current wealth structures or those to be implemented in the future.
I  INTRODUCTION

New Zealand is a member country of the Organisation for Economic Co-operation and Development (OECD) and a member of the Commonwealth of Nations. It has a well-developed infrastructure and is regularly cited as one of the least corrupt countries in the world. In 2017, New Zealand was ranked as the least corrupt country in the world in Transparency International’s Corruption Perceptions Index.

It has a relatively small population for its size (it covers 268,680 square kilometres and has a coastline of 15,134 kilometres; compared with the United Kingdom, which covers 244,820 square kilometres with a coastline of 7,918 kilometres. To further the comparison, the United Kingdom has a population of 65.6 million and New Zealand 4.8 million). These comparisons influence many essential characteristics of the country, including a low level of regulation, stability, and as an attractive, if remote, place to live. New Zealand’s significance in wealth planning arises because of its attractiveness as a migratory destination, and as a centre for international wealth and succession planning. Of particular interest are the absence of most kinds of capital gains, estate or gift taxes, and the incorporation into statutory law of a variety of structures that do not tax overseas sourced income when utilised by non-resident persons.

II  TAX

There is no estate tax or inheritance tax in New Zealand. Gift tax has been abolished. As there are no capital transfers or accumulation taxes in New Zealand, there is no need to employ tax planning that takes into account capital tax protection.

The principal taxes in New Zealand are direct in nature: an across-the-board corporate rate of 28 per cent and a progressive individual rate of up to 33 per cent apply. An indirect tax is levied on the provision of goods and services, and is charged at a rate of 15 per cent.

New Zealand enjoys the following beneficial features for wealth planning purposes:

a  it is a member of the OECD group of countries;

b  it is a domestic taxpaying jurisdiction;

c  it is a party to numerous double taxation treaties and taxation information exchange agreements; and

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1 Geoffrey Cone is the founding partner and Claudia Shan is a partner and head of legal and international compliance at Cone Marshall Limited. The writers would like to acknowledge the assistance of James Gribbin, solicitor.
it has comprehensive anti-money laundering legislation and is a founding member of the Financial Action Task Force (FATF).

### Tax treaties

New Zealand tax treaties generally follow the standard OECD model. Currently, New Zealand is party to 40 double tax agreements, which are summarised in the following table. New Zealand is also a signatory to 19 tax information exchange agreements.

New Zealand is a signatory to the OECD Convention on Mutual Administrative Assistance in Tax Matters, which came into force for the purposes of New Zealand domestic law on 1 March 2014.

In June 2014, the New Zealand government signed an intergovernmental agreement (based on a Model 1A type) with the United States for the implementation of the Foreign Account Tax Compliance Act.

The New Zealand government implemented the OECD Common Reporting Standards (CRS) on 1 July 2017.

The CRS is a system for the automatic exchange of information between countries about the source and beneficial ownership of financial investments. New Zealand will only provide financial account information to the 60 countries that it has deemed to be reportable jurisdictions (the list is subject to change annually).

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<tr>
<th>Country of residence</th>
<th>Interest (%)</th>
<th>Interest paid to associated persons (per cent)</th>
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Country of residence | Interest (%) | Interest paid to associated persons (per cent) | Dividends (per cent) | Royalties (per cent) | Copyright (cultural) royalties (per cent)
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Papua New Guinea | 10 | 10 | 15 | 10 | 10
Philippines | 10 | 10 | 0 or 15 | 15 | 15
Poland | 10 | 10 | 0 or 15 | 10 | 10
Russia | 10 | 10 | 0 or 15 | 10 | 10
Samoa | 10 | 10 | 5, 10 or 15 | 10 | 10
Singapore | 10 | 10 | 5, or 15 | 5 | 5
South Africa | 10 | 10 | 0 or 15 | 10 | 10
Spain | 10 | 10 | 0 or 15 | 10 | 10
Sweden | 10 | 10 | 0 or 15 | 10 | 10
Switzerland | 10 | 10 | 0 or 15 | 10 | 10
Taiwan | 10 | 10 | 0 or 15 | 10 | 10
Thailand | 10 or 15 | 15 | 0 or 15 | 10 or 15 | 10
Turkey | 10 or 15 | 10 | 0, 5 or 15 | 10 | 10
United Arab Emirates | 10 | 10 | 0 or 15 | 10 | 10
United Kingdom | 10 | 10 | 0 or 15 | 10 | 10
United States | 10 | 10 | 0, 5 or 15 | 5 | 5
Vietnam | 10 | 10 | 5 or 15 | 10 | 10
Other countries | 15 | 15 (min) | 30 | 15 (min) | 15

ii Liability for tax in New Zealand

New Zealand tax residents are taxed on their worldwide income. An individual is resident for tax purposes if he or she has a permanent place of abode in New Zealand, or is personally present in New Zealand for one or more periods exceeding 183 days in the aggregate of any 12-month period. The income of non-residents is also subject to income tax if it is derived from a New Zealand source, although the operation of a double tax agreement may limit liability. Employment income is taxable on a gross basis and no deductions are permitted for expenditure incurred in deriving employment income. Employers withhold tax from salary and wage payments under the pay-as-you-earn system. Self-employed individuals pay tax on a net basis and are allowed deductions for expenditure incurred to obtain their income. As mentioned, there is no capital gains tax in New Zealand; however, care must be taken not to buy and sell property within a short period of time or in such a way that a pattern of regular trading activity is established, thereby making any gains taxable under the residential land withholding tax regime or as business income.

iii Overseas income

In New Zealand, an investment that produces overseas income is called a foreign investment fund (FIF). There are three broad categories of FIFs: foreign companies, foreign superannuation schemes and foreign life assurance policies. FIF income is taxed as it accrues, not on distribution to the owner of the FIF. The FIF rules do not apply where an individual has total FIF interests worth less than NZ$50,000 in a particular tax year.

Controlled foreign companies (CFCs) are a subset of FIFs. A CFC is a foreign company that is controlled by five or fewer New Zealand residents (note that there are various de facto tests for control, and the basic de jure standard is that a holding of greater than 50 per cent of the shares on issue will be deemed to be a controlling interest), or that is at least...
40 per cent owned by a single New Zealand resident, where no one foreign resident has a higher individual holding. The FIF rules do not apply to an interest of 10 per cent or greater in a CFC. In such cases the CFC rules come into play.

There are seven methods of calculating FIF income, one of which must be applied to calculate the income of the holder of an assessable FIF interest (i.e., one that is worth NZ$50,000 or more in the tax year in question, and is not subject to the CFC rules). The relevant methods are:

- the attributable FIF income method;
- the comparative value method;
- the deemed rate of return method;
- the fair dividend rate method;
- the cost method;
- the branch equivalent method; and
- the accounting profits method.

There is a consistency rule that requires a person to use the same income calculation method if the person has two or more attributing FIF interests.

The different methods are complex and advice must be taken before determining which method of calculation is to be used. However, in a broad sense the calculations will be made on the basis of reference to the gains or losses overall and not to income derived or distributed. When insufficient information is available to calculate income derived precisely, a deemed rate of return is applied.

An active income exemption applies generally to all interests of 10 per cent or greater in a foreign company. This exemption comes into effect where the active business income test is satisfied. If 95 per cent or more of the income of the CFC or FIF in question is derived from an active business enterprise (as opposed to passive sources of income such as interest, dividends, and royalties), then there will be no attribution of income to the New Zealand-resident holder of that FIF or CFC interest, irrespective of the fact that it might otherwise be considered to be an attributing interest.

Dividends paid to resident persons by foreign companies are generally exempt from tax in New Zealand. Foreign dividend income will, however, be assessable in the hands of a resident individual if the attributable FIF income method is used, or if the individual is subject to an exemption from the FIF rules (including the scenario where the CFC rules apply). Resident companies will be taxed on their foreign dividend income only where the dividend is paid on fixed-rate shares, or where a deduction is granted in respect of the dividend in the jurisdiction of tax residency of the foreign company paying the dividend.

### Credits for tax paid in another jurisdiction

New Zealand taxpayers may claim credits for tax paid in other jurisdictions, even where there is no double tax agreement in place. For the credit to apply, the tax in question must be of substantially the same nature as New Zealand income tax.

### III Succession

#### i Intestacy rules

New Zealand’s intestacy rules are regulated by the Administration Act 1969. The property of the intestate deceased is vested in the Public Trustee, and devolves according to the provisions...
of the Act: in the first instance, to any surviving spouse, children or dependants; in their absence to the parents of the intestate; failing which, the brothers and sisters of the deceased inherit in equal shares. If there are no brothers or sisters, then the property passes first to the grandparents, and in their absence, to the uncles or aunts of the intestate. In the event that none of the heirs identified by the Act are in existence, then the assets are deemed to be bona vacantia, and pass to the government.

ii Wills
New Zealand’s domestic law of wills is based on the English model, as is the underlying principle of complete freedom of testamentary disposition. A person must be 18 years of age before he or she can make a will. A will is subject to certain formalities in wording and in witnessing. A will must be in writing and generally be in a specific format, and words of formality are required. There must be at least two witnesses who are in the presence of the person who makes the will and those persons must subscribe their full names, addresses and occupations. Each page of the will must be signed by the testator and also by the witnesses.

iii Forced heirship
New Zealand recognises the principle of testamentary freedom, and therefore does not have a forced heirship regime. There are, however, several important exceptions to the principle of testamentary freedom. In addition to the standard common law avenues that may be pursued to challenge the validity of a will (lack of testamentary capacity, duress, etc.), there are two statutory mechanisms that allow for courts to intervene and alter the division of an estate as stipulated in the relevant testamentary instrument. The Law Reform (Testamentary Promises) Act 1949 provides for the recognition of promises made by a testator during his or her lifetime to make provision for a person in his or her will, and the satisfaction of that promise from the estate where no provision has been made for the person in question. The Family Protection Act 1955 allows the court to make orders mandating departure from the disposition of assets stipulated in a will where inadequate provision has been made for persons to whom the testator owed a moral obligation of financial support.

Forced heirship planning
New Zealand may be a useful planning jurisdiction in relation to countries that do have forced heirship regimes. Because of the primacy of the doctrine of testamentary freedom, New Zealand law does not recognise the concept of forced heirship. Consequently, there is no corresponding legal category into which a foreign court order based on that concept could be translated. Even in the case where one of the statutory mechanisms for the recognition of foreign judgments, such as those available under the Judicature Act 1908 or the Reciprocal Enforcement of Judgments Act 1934, is applicable, it would be difficult to sustain an action for the enforcement of a foreign judgment, as the New Zealand-resident respondent would usually hold the assets at issue pursuant to some kind of trust.

iv Asset protection planning
New Zealand has no specific asset protection law. However, the laws that cover insolvency and liquidation can effectively provide an asset protection structure.
v Use of trusts

The Trusts Bill (the Bill) is currently before Parliament and aims to modernise and clarify the Trustee Act 1956. The select committee has received submissions on the Bill, but it remains to be seen whether any changes have been made to the first draft. There are some unique features of New Zealand trust law that the Bill will add or build upon, including the ability to have special trust advisers, investment advisers and managers, with wide discretionary powers and the ability to add and remove beneficiaries. A protector or investment manager, who again need not be a New Zealand resident, can be given relevant advisory and discretionary powers. New Zealand is not a signatory to the Hague Convention on the Law Applicable to Trusts and on their Recognition, and some aspects of New Zealand trust law are not compatible with this Convention. New Zealand trusts currently have a maximum trust period of 80 years and the Bill aims to extend this to 125 years.

vi Marital property rights

Marital property, known in New Zealand as relationship property, is regulated by the Property (Relationship) Act 1976. Relationship property claims may be brought by persons who are married or persons who have lived in a permanent relationship. There is no difference whether the relationship is a homosexual or heterosexual relationship. Broadly, all property obtained during the relationship is divided equally. In respect of property that is brought into the relationship, an assessment will be made of any contributions the other party has made to the property after it was introduced.

vii Divorce

Divorce in New Zealand is known as dissolution of marriage. In New Zealand divorce may be obtained on a no-fault basis on grounds of separation for two years. Dissolution of marriage may be obtained by the parties without recourse to legal counsel. An application for dissolution may be made unilaterally or jointly by the parties.

viii Adoption

Under New Zealand law, adoption must be approved by the family court and may be carried out by any persons over 20 years of age. Adopted children enjoy the same succession rights as any biological children of the adopted family.

ix Life insurance strategies

Except in a business context, premiums paid for insurance policies are not tax-deductible in New Zealand. There are, therefore, limited opportunities for insurance planning. In general, the tax treatment of insurance payments in New Zealand depends on what the payment is compensating: insurance for loss of capital assets is non-taxable, but income-replacement insurance may be taxed. Therefore, the receipt of a death benefit will generally be non-taxable.

x Business succession

Most New Zealand businesses are held in partnership or in closely held private companies. Company constitutions and partnership agreements almost always contain provisions that provide for business succession between shareholders. Commonly, these set out a mode of pre-emption on a notice of sale or the death of a partner or equity owner, which enable that person’s share to be valued and disposed of to the continuing owners. Regardless of whether
there are such provisions contained in the rules of the holding entity, in conventional family companies the interest of the outgoing shareholder or partner is valued and the acquisition price for that share is fixed as a debt repayable upon demand, in some cases carrying interest. In the case where the debt is owing to an individual, this debt is often forgiven on that debtor's death by will. An alternative method of disposition of business succession is via a trust. The shares or participation in the company or partnership are held by a trustee, who may distribute those shares to a family member or members at dates agreed by or fixed by the settlor or other members of the family.

xi  Use of offshore companies

Offshore companies have not featured prominently in New Zealand-based planning strategies for some time, because of the introduction of New Zealand's CFC and FIF rules in the late 1980s and early 1990s. Where offshore companies are utilised, they are generally held by overseas entities such as foreign trustees, individuals or foundations. It remains to be seen whether the changes made to New Zealand's international tax regime during recent years will result in a resurgence of the use of offshore companies held directly by New Zealand entities.

xii  Pre-immigration planning

Pre-immigration planning usually involves the establishment of trusts or foreign companies, or both. It is unwise for a New Zealand resident to be holding substantial investment assets outside New Zealand because of the adverse tax and other planning and reporting rules within New Zealand. Failure to plan will reduce flexibility in the future should the individual or members of his or her family wish to leave New Zealand. Therefore, any gifts or transfers of property should be made before a potential donor becomes tax resident or domiciled in New Zealand. Ideally, a family management company should be established outside New Zealand, which will hold the assets to be invested and managed overseas. This company should be owned and controlled by a foreign trustee under a foreign trust to avoid any CFC issues or domestic tax issues in New Zealand. Capital and income that is to be utilised to settle the family in New Zealand and provide the family with a reasonable standard of living should be repatriated to New Zealand and maintained in a separate domestic structure. The overseas structure should be used to enhance and develop the family’s long-term investment wealth, with resort to such funds being used for New Zealand purposes only in exceptional cases.

xiii  Post-immigration planning

Provided a New Zealand resident has been absent from New Zealand for more than 10 years, he or she may obtain the benefit of the transitional residence rules upon re-establishing residence in New Zealand. Those rules exempt a person who is to become a resident in New Zealand from taxation of all income, except that derived from active business enterprises in New Zealand, and the provision of services overseas, for a period of 48 months from the date of establishing tax residency. Accordingly, a returning resident may safely plan to return to New Zealand and, before the expiry of the relevant period, leave New Zealand for another jurisdiction. Alternatively, he or she may utilise the transitional period to set up legitimate overseas structures that will reduce future New Zealand taxation liability.
Mobility planning – generally

New Zealand tax residency is lost after spending more than 325 days in any 12-month period outside the country; however, the maintenance of enduring ties with New Zealand, in particular the retention of a permanent place of abode, may result in tax residency being deemed to have continued. Once tax residency has been lost, the expatriated person will only be liable to tax on income derived from a New Zealand source.

Mobility planning – trailing residency or domicile

Expatriation from New Zealand for tax purposes is achieved by losing tax residency. There are no significant departure issues in New Zealand.

Exit or expatriation tax

There are no expatriation rules or penalties in New Zealand.

WEALTH STRUCTURING AND REGULATION

Trusts

New Zealand trust law is derived from English trust law. For a variety of fiscal reasons, the trust is commonplace in New Zealand. New Zealand trust jurisprudence is robust and well understood by lawyers, judges and accountants.

The New Zealand foreign trust has been a part of New Zealand’s legislative framework since 16 December 1988. It is a simple and logical structure, the result of a deliberate policy of the New Zealand government. The New Zealand exempt trust offers non-residents of New Zealand all the advantages of a conventional tax-free structure within a well-regulated jurisdiction. Features of a New Zealand foreign trust are as follows:

- a trustee holds the trust assets for the persons described in the trust deed as beneficiaries;
- a trust deed describes an equitable and contractual relationship between persons, which is regulated only by the courts;
- the trust is registered with the New Zealand Inland Revenue Department (information is not publicly available);
- a trustee may be a natural person, company or a limited partnership. The trust may have any number of trustees;
- a New Zealand trust may hold property, trade or operate a business;
- a custodial or principal trustee must be a New Zealand resident to be trustee of an exempt trust;
- a trust can be terminated at any time; and
- the trust may operate for a maximum of 80 years (although the Trust Bill aims to increase this to 125 years).

Trusts occupy a particularly favourable position in the New Zealand tax regime. Provided that the assets of the trust are contributed by a non-resident settlor, and none of the trust property consists of New Zealand-situated assets, then in the vast majority of cases the income derived from the holding of those assets can be received by the New Zealand-resident trustee, and distributed to non-resident beneficiaries, without any liability to tax arising in New Zealand.
Apart from the residential land withholding tax that applies to non-residents or entities controlled by non-residents who purchase residential property located in New Zealand, there is no capital gains tax in New Zealand. Any capital increase in the value of the trust’s assets is, therefore, not taxable.

ii  Limited partnership

Limited partnerships were introduced into New Zealand law by legislation enacted in March 2008. A limited partnership comprises at least one limited partner, and a general partner who is the manager of the limited partnership. The limited partner may not, subject to minor exceptions, take part in any management activity. In return, the limited partner enjoys the protection of limited liability in respect of the debts and liabilities of the partnership. The partners may be natural or legal persons, and need not be New Zealand residents. However, requirements that a partnership should have at least one general partner that is either a New Zealand incorporated company, a New Zealand resident person or a New Zealand unlimited partnership have come into effect on 1 September 2014. The partners may or may not have a participation in the capital of the limited partnership, although the limited partner would usually be granted an equity interest in the partnership in return for contributing the capital used to establish the partnership.

A limited partnership, as distinct from a general partnership, is treated in New Zealand as having a separate legal personality. It is registered in the same way as a company with the New Zealand Companies Registry. The public information in the Companies Registry comprises the name of the limited partnership, details of its registered office and the identity of the general partner. The identity of the limited partner is protected as confidential information in terms of the legislation. The partnership agreement is a private document and is not registered in the Companies Office.

Limited partnerships are transparent for tax purposes. In other words, in determining their liabilities under the Income Tax Act, the Inland Revenue Department of New Zealand will attribute the partnership’s income, expenses, tax credits, rebates, gains and losses to the underlying partners in proportion to their partnership interests.

The limited partnership can be particularly useful in offshore wealth planning. The partnership will generally be recognised as a separate legal entity under foreign law, and therefore can be useful in mitigating the problems associated with the lack of recognition of trusts in certain jurisdictions. A foreign trust could act as the limited partner of the partnership, with 100 per cent of the partnership interests being held by the trust. The income generated by the partnership assets would therefore flow through to the trust in its entirety, and would be eligible for all of the benefits enjoyed by foreign trusts under New Zealand law. The identity of the limited partner would also be confidential, and could only be disclosed in a limited number of circumstances.

iii  Foreign investment zero-rate portfolio investment entities

New rules have been introduced for the taxation of collective investment vehicles resident in New Zealand, or portfolio investment entities (PIEs). These rules are aimed at making New Zealand more attractive as a jurisdiction for funds administration.

The major problem with the taxation of PIEs under the previous regime was that foreign-resident investors in PIEs were taxed fully on the income attributed to them,
irrespective of the fact that the PIE may have derived that income entirely from sources outside New Zealand. This was in contradiction to the basic policy of the New Zealand tax base that non-residents should only be taxed on New Zealand-sourced income.

The new rules provide the opportunity for a PIE to elect to be treated as a foreign investor zero-rated (FIZR) PIE (for tax purposes), which allows foreign investors to be taxed at a rate of zero per cent on the foreign-sourced income they derive through the FIZR structure.

An entity must meet the general criteria for becoming a PIE before it can elect to be treated as an FIZR. In very simple terms the general criteria are:

- the entity must make investments on behalf of one or more investor classes; one of which must not have less than 20 members, and none may own or control 20 per cent or more of the interests in that investor class;
- the entity, which may be a company or a unit trust, must be resident in New Zealand; and
- the holdings of the entity must comprise at least 90 per cent passive income-generating assets.

The New Zealand administrator of the PIE will be either a New Zealand trustee or the directors of a PIE company. In the case of a company, it is suggested that a separate company administrator be appointed.

If it is treated as an FIZR for tax purposes, the PIE may attribute its income to its investors at a rate of zero per cent if the following two conditions are fulfilled:

- the income of the entity is entirely foreign-sourced; and
- the investors are notified foreign investors (NFIs).

NFIs are non-New Zealand-resident investors. They may be natural persons, or any other legal entity, including a New Zealand exempt trust. The NFI must provide the FIZR PIE with the personal information of the NFI, which will be held by the administrator of the FIZR PIE. The NFI must also certify that it is a recommended investor.

The PIE must file a tax return each year and prepare accounts. These accounts need not be audited or publicly filed.

iv New Zealand’s anti-money laundering regime

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML Act) was fully implemented on 30 June 2013 and imposes several obligations on reporting entities. In September 2017, the AML Act was amended to extend the core obligations of reporting entities to real estate agents, lawyers, accountants, conveyancers, the New Zealand Racing Board, and some high-value dealers. It also established the Departments of Internal Affairs as the relevant anti-money laundering supervisor for those entities. Entities that fall within the definition of reporting entities need to take the following steps to be compliant:

- prepare a written risk assessment of the money laundering and financing of terrorism that could be expected in the course of business;
- establish and maintain an anti-money laundering and counter-terrorist financing programme that includes procedures to detect, deter, manage and mitigate money laundering and the financing of terrorism;
- appoint a compliance officer to administer and maintain the programme (above);
- perform customer due diligence processes based on the risk assessment, including customer identification and identity verification;
perform suspicious transaction reporting, prescribed transaction reporting, auditing and annual reporting systems and processes; and

keep records of all the above for a period of no less than five years.

The AML Act takes a risk-based approach to compliance. Reporting entities (within the limits set by the AML Act and its regulations) have some flexibility to determine the way in which they meet their obligations based on their risk assessment.

There are several supervisory bodies that regulate the application of the AML Act:

- the Financial Markets Authority;
- the Reserve Bank of New Zealand; and
- the Department of Internal Affairs.

V OUTLOOK AND CONCLUSIONS

As mentioned, New Zealand has a lightly regulated economy. It has recently passed tax reforms, considered in the body of this chapter, that make its taxation system simpler, as well as reducing income tax rates. This has resulted in an increase in high net worth families and individuals moving to New Zealand.

New Zealand is also overhauling the financial advisory system. Recent financial market reforms include changes to the regulation of capital raisings, and to how financial products and services are created, promoted and sold.

The financial crisis has not affected New Zealand’s banking system, although a moderate slowdown occurred in the economy following the 2008 crisis. New Zealand has, however, not been significantly affected by this downturn. As a founding member of both bodies, New Zealand is fully compliant with FATF and OECD standards and is known as a transparent and safe jurisdiction. As the taxation system in New Zealand is simple, and the government runs a surplus, there is no foreseeable need to change the tax system for fiscal reasons. New Zealand has a voluntary taxation system, and the absence of wealth and most capital taxes makes it an attractive place to live and invest.
I  INTRODUCTION

Poland is a neutral jurisdiction to individuals of significant wealth, which means that Poland provides neither positive nor negative regulations for the wealthiest individuals. On the one hand, the lack of such taxes as wealth tax and exit tax, and relatively low tax rates, makes Poland an attractive place to keep personal wealth. On the other hand, Poland conforms with current global trends aimed at closing the remaining loopholes in its tax system through the introduction of various regulations, such as controlled foreign corporation (CFC) rules, general anti-abuse rules (GAAR), new transfer pricing documentation requirements and taxation of joint-stock partnerships. It is significant that Poland participates in the Base Erosion and Profit Shifting (BEPS) project and implements the Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards the mandatory automatic exchange of information in the field of taxation. Poland has signed many double tax treaties (more than 80 conventions) and international agreements on the exchange of information on tax matters. These act as a deterrent to individuals who intend to keep their wealth in Poland.

II  TAX

There are two types of tax obligation in Poland: unlimited and limited. Unlimited tax obligation is constituted when individuals with their place of residence in Poland are taxed on their worldwide income, regardless of where the income is earned. The limited tax obligation arises when individuals do not have a place of residence in Poland, and they are taxed solely on their income derived from Polish sources. It should be stressed that, from 2017, the Polish legislator has extended a list of circumstances in which the income of non-residents is deemed to be generated in Poland. The extended list includes:

a  any kinds of operation undertaken in Poland, including operation of a foreign facility located in Poland;

b  a property located in Poland or rights to such a property, including sales thereof in its entirety or part, or sales of any rights to such a property;

c  securities and derivative financial instruments not being securities allowed for public trading in Poland in the regulated stock exchange market, including those obtained through sales of such securities or instruments and exercising rights stemming from them;

\[1\]  Slawomir Łuczak is a partner and Karolina Gotfryd is an associate at Sołtysiński Kawecki & Szlęzak.
the deed of ownership transfer of shares in a company, the whole of entitlements and obligations in a company not being a legal person or deeds of participation in an investment fund or a collective investment scheme where at least 50 per cent of the value of assets, directly or indirectly, constitute properties located in Poland or rights to such properties; and

regulated titles due, including left for disposal, paid or deducted by natural persons, legal persons or organisational units not having a legal entity, with residence, registered office or management in Poland, irrespective of the place where the agreement was concluded or where the service is delivered.

A progressive income tax scale that is widely used in other EU countries, such as France, Sweden and the Netherlands, is applied to individuals in Poland. Tax rates vary depending on income earned, defined as: ‘the total revenue minus tax deductible costs, earned in a given taxable year’. The Polish tax bands are relatively low: 18 per cent and 32 per cent. Poland is in ninth position in the ranking of progressive tax rates in EU countries regarding higher tax rates (32 per cent), and in 14th position concerning lower tax rates (18 per cent).2 Nevertheless, according to statistics, only approximately 3 per cent of taxpayers pay the higher tax band of 32 per cent.3 Most wealthy taxpayers optimise their profits using regulations intended for natural persons conducting business activity. These individuals are taxed according to the tax scale; however, at their request, they may tax their income at a 19 per cent flat rate, which is dedicated to natural persons conducting a business activity. It may be assumed that the most affluent Polish taxpayers are self-employed in Poland for tax purposes.

The richest Poles often derive their income from capital gains (dividends, interests, profit on the sale of shares), which are not covered by social security contributions, and it is taxed with a 19 per cent flat-rate tax (whereas in Germany and Ireland it is 25 per cent and in Scandinavian countries it is more than 30 per cent). Income from capital gains is not counted in the overall income.

In many countries, high tax rates are connected with a high tax-free personal allowance; however, this is not the case in Poland, where the tax-free amount is the lowest of all EU countries (approximately €750).4 It is worth stressing that the Polish Constitutional Tribunal recently issued a judgment (Case No. K 21/14) in which it stated that the level of tax-free amount is unconstitutional insofar as it does not provide a correction mechanism for the tax-free amount to ensure a minimum standard for living. Hence, from 2018 the tax-free allowance for low earners has been increased to 8,000 zlotys. In cases of earnings higher than 8,000 zlotys, the allowance is decreasing depending on the income. Where yearly earnings exceed 127,000 zlotys, the personal allowance is not applicable at all.

A taxpayer’s personal and family situation may be taken into account in the tax system, especially in relation to income tax, in the form of reliefs and tax exemptions.5

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5 K Święch, Pozycja rodziny w polskim prawie podatkowym, Warsaw 2013, p. 133.
Poland, like most other EU countries, provides various tax credits, such as an internet tax credit, a tax credit for an individual retirement security account and a tax credit for charitable donations. Since the Polish tax system is in favour of families in many tax respects, a large part of tax credits concern a taxpayer’s personal situation. Therefore, Polish income tax provides a child tax credit, joint taxation (with children) of single parents and joint taxation of spouses, the aim of which is to ensure a family has a reduced financial burden. At this point it should be noted that the preferential treatment of families also appears in gift and inheritance tax, where the immediate family members of the testator are exempted from tax.

As of 1 January 2015, numerous amendments to the Polish Personal Income Tax Act relating to cross-border structuring entered into force, such as the introduction of CFC rules, new transfer pricing documentation requirements and comprehensive regulations regarding the provision of information on interest payments, implementing Directive 2014/48/EU of 24 March 2014. The above changes aim to close loopholes in the Polish tax system.

From an individual taxpayer’s perspective, the most crucial change is the introduction of CFC rules that revolutionise international tax planning and optimisation. The Polish legislator’s aim was to tax income derived by Polish tax residents from foreign companies when such income is not taxed in the company’s country of residence or the tax is too low (lower than 14.25 per cent). From 2018, the Polish legislator introduced the effective tax rate instead of a nominal rate. This means that a subsidiary company will be considered as CFC, when the income tax actually paid by the company is lower than the tax that it would pay in Poland. Under new provisions, an additional income tax (19 per cent) is imposed on shareholders holding at least a 50 per cent (25 per cent until 2017) direct or indirect holding in entities deriving their revenues mainly (more than 33 per cent) from passive income (i.e., dividends, interests, royalties, share disposals). CFC rules also affect taxpayers who are shareholders of entities that have a seat or place of management in a tax haven. Polish taxpayers who own CFCs will also need to keep a register of qualifying foreign entities and a record of transactions occurring in the foreign entities, and file a special annual return in Poland.

As for transfer pricing documentation, new provisions impose new requirements on taxpayers conducting related-party transactions, which means more comprehensive information on related-party transactions should be disclosed to the tax authorities. Under these new provisions, taxpayers are obliged to prepare more extensive transfer pricing documentation (in particular, local files are expanded). According to the new provisions, taxpayers whose annual revenues and expenses exceed €20 million in the preceding financial year are also obliged to provide master file documentation that includes, among others, the group’s capital structure, transfer pricing policy and detailed information on intellectual property. Additionally, the biggest Polish taxpayers with consolidated revenues exceeding €750 million are obliged to provide country-by-country reporting. It should be stressed that some changes in transfer pricing provisions are favourable for taxpayers whose revenues and expenses do not exceed €2 million in a given year, as they do not need to prepare transfer pricing documentation.

As already mentioned above, Polish tax law provides for neither wealth tax nor exit tax. However, recently, the Polish government revealed details of the solidarity tax. The tax will be paid by taxpayers earning over 1 million zlotys a year and the rate will be 4 per cent from the surplus over this amount. The solidarity tax, together with a part of the Labour Fund contribution (amounting to 0.15 per cent of its base), will be credited to the Solidarity Support Fund for the disabled. In this way, the Polish government wants to raise funds to
support the disabled. The solidarity tax will be paid for the first time on income obtained in 2019, which the taxpayer will settle by making a statement in 2020. Nevertheless, the government has not provided for the detailed draft of the law.

III SUCCESSION

The Polish law of succession is mainly regulated in the Polish Civil Code. However, specified provisions regarding the law of succession are also found in other statutory laws (e.g., banking law, labour law and the Code of Commercial Companies). The right to inherit is protected by the Polish Constitution, which states that everyone has the right of succession and this right is equally protected by the law.

The law of succession is based on legal principles, namely testamentary freedom and the protection of relationships between family members.\(^6\)

The right to succession may result from two sources: the will or the statute (the Polish Civil Code). It should be noted that a will takes precedence over the statutory inheritance. A testate succession occurs when a testator (a person with full legal capacity) expresses his or her last will through one of three forms of will. The first is the simplest: the will should be written entirely by the hand of the testator, who must sign and date it. The second may be made in the form of a notarial deed. The third is to make a will by declaring its content orally before a local government officer in the presence of two witnesses.

Statutory succession should be applied when no (valid) testament exists or the persons who were appointed as heirs in the testament disclaimed the testament or are unable to become heirs. There are four groups of heirs under Polish succession law. The range of these entities is determined by family ties, such as blood ties, marriage or adoption.

In the first group, the surviving spouse and descendants will inherit. Here, the principle that children and a spouse inherit in equal parts applies; however, the spouse's share cannot be less than a quarter of the entire estate. In the second group, in the absence of descendants, the spouse and deceased’s parents will inherit. In this case, the inheritance attributable to the spouse must correspond to half of the deceased’s estate. If the deceased’s parents have died, the inheritance attributable to this parent goes to the testator’s siblings or, if the deceased’s siblings have died, their children. The third group of heirs is entitled to the succession solely when there are no heirs in the first two groups. This category includes the deceased’s grandparents or, if they are also deceased, their children. The fourth group consists of children of the deceased person’s spouse whose parents were not alive when the estate was opened. Last of all, the municipality in which the decedent last resided will inherit, or, if the deceased’s residence cannot be determined or is located abroad, the State Treasury.

Here, it should be indicated that the sequence of the inheritance and the range of the entities entitled to the succession presented above is a result of amendments to Polish succession law from 2009. So far, provisions in scope of statutory succession have been rigorous and have prevented grandparents and their descendants from succession. Another key change is the testator’s stepchildren’s entitlement to the succession; however, they inherit only when their parents have passed away. The amendment was designed to strengthen family ties and limit the municipality’s and State Treasury’s access to the succession in a situation where a member of the testator’s family is still alive.

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It is noteworthy that heirs may either accept succession without the limitation of liability for debts (simple acceptance), or accept succession with the limitation of such liability (acceptance with benefit of inventory). Alternatively, heirs may reject the inheritance within a time limit of six months from the day when they became aware of their title to inherit. Until 2015, when no statement of intent was submitted within the prescribed time limit, heirs were deemed to have accepted the inheritance and were liable for debts without any limit. Such a state of affairs was deemed socially unfair. Therefore, since 18 October 2015, provisions concerning liability for debts under succession have been changed to be analogous with the latest European codifications. According to the new regulation, if heirs do not do anything within a time limit of six months from the day they become aware of their title to inherit, their liability for debts will be limited to the assets of inheritance (acceptance with benefit of inventory).

A testator may appoint an executor to ensure that all the testamentary provisions will be properly conducted; however, the executor cannot be treated as a fiduciary or a trustee.

Polish law forbids mutual wills and contracts of inheritance, with the only exception to this rule being a contract of renunciation of inheritance, in which a person who belongs to one of the classes of statutory heirs renounces his or her statutory inheritance after the testator's death.

There have been no changes affecting personal property, such as developments on prenuptial agreements and same-sex marriages. Same-sex marriages are illegal in Poland; therefore, people in a same-sex relationship are not subject to intestate succession. However, there are no obstacles to prevent either party in such a relationship from drawing up a will that decides who will receive a party's estate. It should be noted that Polish succession law protects the closest relatives of a deceased person by forced share. Only descendants, a surviving spouse, and the deceased’s parents have the right to a statutory portion.

Nevertheless, a person in a same-sex relationship can receive the right to a tenancy from the deceased partner. This was confirmed by the Supreme Court in its resolution (Case No. III CZP 65/12) of 28 November 2012, in which it was held that the person of the same sex who is connected through emotional, physical and economic ties with the tenant may receive the right to the tenancy from the deceased partner just as a wife or a cohabiting partner.

Prenuptial agreements do not change the rules for passing on inheritance, including the intestate succession rules, which are binding when the testator does not draw up a will. This means that spouses who have concluded a prenuptial agreement inherit from each other according to succession law principles. This agreement may affect the seizure of assets of the inherited wealth only (there is no succession of the couple’s property, only the individual property of the deceased spouse).

Natural persons are the only taxpayers of inheritance tax. Inheritance tax is imposed on acquisitions as a result of inheritance of property (movable and immovable) located in Poland, and property rights exercised in Poland, including money. Tax is also applied to the acquisition of property located outside Poland and rights exercised abroad if at the time of the deceased’s death, the beneficiary was a Polish national or had a permanent place of residence in Poland. If neither the deceased nor the beneficiary were Polish citizens or had permanent residence in Poland at the moment of death, inheritance tax is not levied.

Payers of inheritance tax are grouped into three categories depending on their relationship with the testator. The first group consists of the spouse, descendants (children, grandchildren, etc.), ascendants (parents, grandparents, etc.), sons-in-law, daughters-in-law, siblings, stepfathers, stepmothers and parents-in-law. The second includes descendants of
siblings (nieces, nephews, etc.), siblings’ spouses, siblings of spouses, the spouse’s siblings’ spouses, other descendants’ spouses’ siblings of parents (aunties, uncles, etc.) and stepchildren’s descendants and spouses. Finally, the third group includes other acquiring parties, including unrelated parties.

Determining the base and rate of Polish inheritance tax depends on the specific tax group the testator belongs to and on the minimum tax-exempt amount. Currently, tax-exempt amounts are as follows:

- for acquirers from tax group 1: 9,637 zlotys;
- for tax group 2: 7,276 zlotys; and
- for tax group 3: 4,902 zlotys.

Tax on inheritance applies to the acquisition of ownership of assets over the tax-free amount. The table below presents the rates of Polish inheritance tax:

<table>
<thead>
<tr>
<th>Taxable base</th>
<th>Tax scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above 10,278 zlotys</td>
<td>3%</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>7%</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>12%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxable base</th>
<th>Tax scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above 10,278 zlotys</td>
<td>5% of the surplus over 10,278 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>7% of the surplus over 20,556 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>12% of the surplus over 20,556 zlotys</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxable base</th>
<th>Tax scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above 10,278 zlotys</td>
<td>6% of the surplus over 10,278 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>9% of the surplus over 20,556 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>16% of the surplus over 20,556 zlotys</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxable base</th>
<th>Tax scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above 10,278 zlotys</td>
<td>7% of the surplus over 10,278 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>12% of the surplus over 20,556 zlotys</td>
</tr>
<tr>
<td>Above 20,556 zlotys</td>
<td>20% of the surplus over PLN 20,556 zlotys</td>
</tr>
</tbody>
</table>

The taxpayer has 14 days from the day the decision of the revenue office determining the tax rate (unless it was collected earlier by the notary) has been delivered to pay the inheritance tax. Poland is unique among tax jurisdictions across the world for exempting the testator’s immediate family members from inheritance tax. This is aimed at accumulating the family’s wealth across generations, and therefore the provisions of inheritance tax give preference to the family. The beneficiaries need to report the acquisition to the competent head of their tax office within six months of the day the tax obligation has arisen.

On 6 June 2018, the Supreme Administrative Court issued a precedential judgment that may revolutionise the taxation of donations (Case No. II FSK 1525/16 and II FSK 1526/16). In this ruling it is stated that a taxpayer who, by executing the order of a testator or donor, purchased a thing for himself or herself for money from the inheritance or donation, will not pay tax on the part of the estate issued in accordance with this order.

In practice, this means that with the appropriate order in the donation, all taxpayers – particularly from the third tax group, who settle with the tax authorities according to the highest tax rates – could avoid paying the tax. Moreover, the testator or donor’s immediate family would be released from the obligation to report the acquisition of the gift or inheritance to the tax authorities.
On 8 June 2018, the Polish parliament passed an Act on the management of the succession of the individual enterprise. The Act has been submitted to the Senate (the upper house of the Polish parliament) and to the President.

The main assumption of the Act is to enable a smooth continuation of a company’s operation after the death of its owner.

Sole proprietorship is the most popular form of conducting business activity in Poland. The vast majority of Polish entrepreneurs (80 per cent) operate on the basis of an entry into the Central Register and Information on Business (CEIDG). Currently, when the owner of a company entered into CEIDG dies, his or her heirs may not continue running the business. The entrepreneur’s death results in the expiry of many company rights (e.g., to use TIN or licences and concessions, and obtain tax rulings).

The new law assumes that, after the death of the owner of the enterprise, the company will be able to retain employees, TIN and continuity of tax settlements; it is also possible to execute concessions or permits and tax rulings obtained by the entrepreneur, as well as commercial contracts concluded by him or her. The new regulations are also aimed at enabling entrepreneurs to set up the succession manager who will take over the running of the company after the owner’s death.

According to the Act, the succession manager will manage the company from the death of the person running the company until such time as the inheritance is divided between the heirs. The succession manager will be appointed by a business owner or a spouse or the people inheriting the enterprise – after the death of the business owner – and may be a natural person who has full legal capacity, regardless of whether he or she is related to the entrepreneur or not, and regardless of whether he or she professionally deals with property management. The Polish legislator intends to introduce an incentive to take over and run family businesses.

The incentive takes the form of an exemption from inheritance tax on the acquisition of an enterprise. At present, only the testator’s immediate family may benefit from such exemption. After the change of the regulations, the tax exemption will also apply to the persons who will run the business, regardless of the relationship with the deceased entrepreneur. The condition for obtaining the exemption will be the notification of the purchase of the enterprise to the head of the tax office and running the acquired company for at least five years.

The new regulation should encourage the continuation of the company, even if the immediate family of the deceased entrepreneur does not have relatives who will undertake to continue the business.

IV WEALTH STRUCTURING AND REGULATION

For wealth structuring, Polish taxpayers commonly use regulations and structures available in Poland as well as in foreign countries. So far, trusts and private foundations are unknown to the Polish legal system, and therefore they are not widely exercised in Poland. However, it is increasingly being argued that it is necessary to introduce the institution of the family foundation into the Polish legal system. Nevertheless, the wealthiest taxpayers willingly benefit from foreign foundations and trusts located in countries that provide these regulations, such as Austria, Liechtenstein, the United Kingdom, and the Netherlands.

Until 2017, optimisation structures in Poland were established by using closed-end funds. However, in January 2017 the taxation of investment funds was changed. The new
provisions have repealed the existing regulations constituting a basis for exemption from corporate income tax for Polish closed-end investments funds (CIF) and foreign collective investment institution of a closed type.

In practice, this means that profits of these funds derived from participation in Polish or foreign tax partnership; from interest on loans granted to such entities; from interest on equity contributions to such entities; from donations and fully and partially free-of-charge performances of such entities; from securities issued by these entities and from the sale of participation in such entities are subject to the standard income tax of 19 per cent.

Above-mentioned exclusions from the corporate income tax (CIT) exemption aim at the elimination of tax-optimisation schemes involving Polish CIF, which has been a part of the chain of tax transparent vehicles, including Luxembourg special limited partnership.

However, it should be noted that some types of CIF income are still exempt within specific exemption and considering the above exclusions (e.g., income from real property directly owned by CIF).

Polish open-end funds and special open-end funds (not applying the policies of closed-end funds) may benefit from full tax exemption without any limitations.

As for funds from the European Union or European Economic Area, there is CIT exemption for them when:

a. they are subject to income tax in the state where they have their registered office on all of their income, wherever obtained;
b. the only subject of their activity is collective investment of funds raised through a public offering of participation units in securities and money-market instruments;
c. they operate pursuant to a licence from the competent financial market regulator in the state where they have their registered office;
d. their activity is subject to direct supervision by the competent financial market regulator of the state where they have their registered office;
e. they have a depository holding the fund’s assets; and
f. they are managed by entities operating pursuant to a licence from the competent financial market regulator of the state where such entities have their registered office.

The above eligibility for CIT exemption will only be applicable in cases when foreign funds operate in a country with which Poland has concluded a double tax treaty or other international agreement allowing Polish tax authorities to receive tax information from the tax authorities of the investment funds.

The CIT exemption is not applicable to collective investment undertakings when:

a. they operate in the form of a closed-type collective investment undertaking or are an open-type collective investment undertaking operating under the investment rules and restrictions applicable to closed-type collective investment undertakings; and
b. under their founding documents their participation units are not offered through a public offering or admitted to regulated trading or an alternative trading system and can also be acquired by natural persons only if they make a one-time acquisition of participation units of no less than €40,000.

Until 2014, the use of a joint stock partnership was possible for tax optimisation purposes; however, the Polish legislator became aware of this well-known trend and decided that joint-stock partnerships are subject to corporate income tax. Imposing corporate income tax on joint-stock partnerships that were tax-transparent forced taxpayers to find other ways to
find tax optimisations. Limited partnerships (LPs) turned out to be an effective alternative. An LP is a very popular form of conducting business as it enables the partners’ liability to be limited and is not subject to CIT. It should be clarified that LPs are entities without a legal personality and they are created by two types of partner: a partner whose liability for the company’s obligations is unlimited and who conducts the company’s affairs and represents it in all issues before third parties; or a partner with limited liability who is obliged to a fixed amount, which does not need to reflect the partner’s contribution to the LP.

To connect benefits from limited liability (not only for tax arrears purposes) with the tax advantages resulting from the tax transparency of partnerships, it is worth considering the establishment of a hybrid company, such as a limited liability company or limited partnership.7

The general partner in this entity is a limited liability company that conducts the company’s affairs and represents it, and, therefore, its liability is unlimited (in practice, it will be limited exclusively to the company’s assets because of its legal nature). A limited partner is a natural person who can also be a shareholder of a general partner.

Tax burden optimisation for income tax is carried out through an appropriate profit distribution between general and limited partners. To achieve a measurable benefit in the tax law area, profit distribution should be done in a way that the profit of the general partner is considerably lower than the profit of the limited liability partner (e.g., unlimited liability partner: 1 per cent; and limited liability partner: 99 per cent).

This interesting hybrid is a type of partnership that is neither a taxpayer of CIT nor personal income tax. This means the partners in a limited partnership (natural persons) should pay personal income tax. The taxpayer’s income from participating in a partnership is determined proportionally to the right to a share in the partnership’s profit. This income is cumulated with general income subject to the progressive tax rate. The taxable person may tax its income from non-agricultural activity according to the linear rate of personal income tax at 19 per cent.

As for a limited liability company, it is a capital company and, therefore, it is double taxed, which means that taxes are paid both by the company (19 per cent on income earned) and the shareholders (19 per cent from dividends); hence, why a general partner’s profit should be reduced to the minimum.

While discussing different ways of tax optimisation, issues regarding the general anti-avoidance rule in Poland should not be omitted. The fate of this clause in Poland seemed to be tortuous, but eventually the Polish government enacted a GAAR, which came into force on 15 July 2016.8 The general anti-avoidance rule was created as a new tool that the tax authorities may apply to reclassify business operations where a taxpayer was demonstrated to have obtained substantial tax profits through tax-avoidance strategies. Achieving ‘tax benefit’ through artificial arrangements prejudges the possibility of applying the anti-abuse rule. The term ‘tax benefit’ should be understood as ‘reducing, avoiding or postponing the taxpayer’s

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8 GAAR was originally introduced in the 2003 Tax Ordinance Act and this provision continued to be applied until May 2004 when the Polish Constitutional Court held that the GAAR provision was unlawful because it did not meet the constitutional requirements of appropriate legislation and repealed this rule. Since then, the Polish tax law system did not have a general anti-avoidance rule until 2017; however, some attempts in the past were made to introduce this clause with regard to closing remaining loopholes in Polish tax law.
tax liability, creating a tax payment surplus or an entitlement to a tax refund, or increasing the amount of tax payments surplus or tax refund’. To decide whether a legal arrangement is artificial or not, various factors should be taken into account, such as excessively complex transactions. It should be noted that when a taxpayer obtains a ‘tax benefit’ that does not exceed 100,000 zlotys in a given settlement period, the GAAR will not be applied. The clause allows the tax authorities to ignore artificial legal arrangements, which means taxpayers may be obliged to pay the avoided tax with default interest and become exposed to criminal fiscal liability. To protect taxpayers from the tax authorities’ discretionary powers, the Council for Tax Avoidance Matters, a collegiate body independent of the tax authorities, was created. The Council issues non-binding opinions on whether the GAAR should be applied in a given case or not, at the request of the taxpayer or the competent authority. Moreover, the taxpayer may apply to the Minister of Finance to issue an opinion, which disallows the application of the GAAR. The cost of this opinion is 20,000 zlotys.

The Polish GAAR is applicable as *lex generalis* to other specific anti-avoidance rules. The Polish Ministry of Finance states that the GAAR should be applied only as a last resort when other measures (i.e., specific anti-abuse rules) fail.

It is noteworthy that, since May 2017, the Polish Ministry of Finance has been publishing a series of documents, including a warning about the possibility of applying GAAR to certain aggressive tax-optimisation schemes. The Ministry warns in its statements against application of the tax optimisation using closed-end investment funds and bonds purchased as part of a group of affiliates; tax capital groups and the structures with use of foreign companies.

The Polish legal system covers money laundering in criminal law provisions, securities law, banking law and certain provisions of a *lex specialis* nature (including EU legislation).9 Criminalisation and preventing money laundering is based on the Penal Code (in particular, Article 299), the Act of 16 November 2000 on counteracting money laundering and financing terrorism, the Act of 28 October 2002 on the Acts prohibited under the Punishment Act, and the Act of 31 January 1989 on banking law.

The definition of ‘money laundering’ in Polish law is broad, as it covers not only funds from an illegal activity but also legal funds that are ‘hidden’ from taxation.


In the provisions of the Act, information such as the following may be found: the definitions of ‘obliged entities’ and ‘beneficial owner’; competent authorities responsible for counteracting money laundering and financing terrorism; obliged entities’ responsibilities; principles for providing information to the General Inspector; the procedure for suspending transactions and blocking accounts; specific restrictive measures against persons, groups and entities; controlling obliged entities; protecting and disclosing collected data; and pecuniary penalties and penal provisions.

Besides credit and financial institutions, obliged entities are: auditors, external accountants, tax advisers, notaries, and other independent legal professionals, such as

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attorneys and legal advisers. The personal scope of this Act also covers an entrepreneur (both natural and legal person) conducting a transaction exceeding the equivalent of €15,000 who is obliged to register such transaction. This obligation also occurs when a transaction is carried out by more than one single operation but the circumstances indicate that they are linked and that they were divided into operations of less value with the intent of avoiding the registration requirement.

The Act on counteracting money laundering sets out several duties of obliged entities, which include registering any transaction exceeding €15,000, keeping specified records, carrying out ongoing analyses of conducted transactions, conducting risk assessment for money laundering, and financing terrorism and applying financial security measures.

A new act on counteracting money laundering came into force on 13 July 2018. The most important changes resulting from this act will be lowering the threshold for reporting cash transactions up to €10,000 and increased penalties for violation of duties from 750,000 zlotys up to a maximum of €5 million or 10 per cent of the turnover shown in the financial statements for the last financial year. New obliged entities, such as entrepreneurs operating in the cryptocurrency and trust sectors, will be covered by the anti-money laundering responsibilities and the introduction of open and publicly available central registry of beneficial owners, effective as of 13 October 2019.

Poland is not a member of the Financial Action Task Force (FATF); however, it is involved in the group’s activities. Poland not only replies to the questionnaires sent by FATF’s experts, but also participates in the meetings of the working parties (i.e., FATF and Moneyval).10

V OUTLOOK AND CONCLUSIONS

It may be assumed that there is a regressive tax regime in Poland, as taxes for the most affluent people are lower than in other Western countries, whereas for the poorest, they are higher. Poland does not have a national tax policy for the richest individuals; most wealthy Poles have their wealth taxed outside the territory of Poland in countries that provide more advantageous tax treatment, such as Luxembourg, Cyprus and the Netherlands.11 Poland has begun its battle to prevent tax avoidance and tax evasion through introducing numerous regulations designed to combat this negative phenomenon. It would not be an exaggeration to say that Poland is becoming a less tax-friendly country, which consciously limits the possibility of tax optimisation.

For several years, there has been a trend in Europe to close remaining loopholes in national tax law to prevent aggressive tax planning, tax avoidance and tax evasion: from the flagship project of the Organisation for Economic Co-operation and Development – BEPS to the work carried out by the Commission in the area of anti-avoidance package and domestic regulations of particular countries.

11 Information provided in the article: Czy najbogatsi Polacy odprowadzają dochody do rajów podatkowych?, available on the website: www.totalmoney.pl/artykuly/173464,konta-osobiste,czy-najbogatsi-polacy-odprowadzaja-dochody-do-rajow-podatkowych,1,1.
The Ministry of Finance has not conducted an analysis concerning the estimation of the scale of BEPS from the results of the Supreme Chamber of Control’s report. So far, the BEPS action plan has had little influence on Polish domestic tax law.

Nevertheless, significant changes have been made in Polish tax law recently. As of 1 January 2015, numerous amendments to the Polish Personal Income Tax Act have entered into force. Changes include the introduction of CFC rules, strengthening thin-capitalisation rules and the introduction of a number of new transfer pricing documentation requirements. However, only the transfer pricing provisions reflect the OECD’s recommendations provided for in the BEPS project and they remain in line with the guidelines included in the Final Report of Action 13.

In contrast, the BEPS project has had a huge impact on Polish tax treaty law. In its answer to the letter of 8 February 2016 concerning the impact of BEPS on treaty policy, the Polish Ministry of Finance stated that the Ministry is actively engaging in the BEPS project, which has been assessed as an important initiative to prevent the loss of tax revenues at national and international levels. This approach would seem to be supported by the actions taken by the Polish Ministry of Finance.

During the period from 2012 to 2015, Poland concluded seven new double tax treaties, eight protocols amending double tax conventions and 15 agreements on the exchange of information on tax matters. According to the Polish Ministry of Finance, the main objectives of the above-mentioned are to limit the use of double tax treaties; to reduce opportunities for aggressive tax planning; to strengthen control mechanisms through an effective exchange of tax information; and to extend the list of types of income generated in a state where it will be covered by a credit method and it will be taxable in that state. The Polish Ministry of Finance stated that it recommends implementing selected solutions of the BEPS Action Plan. The Polish Ministry of Finance will propose new BEPS provisions concerning the principal purpose test; permanent establishment with the anti-avoidance rule; the tie-breaker rule; and hybrid entities to its treaty partners. Because of the wide scope of work undertaken in the BEPS project, the analysis evaluating proposed measures that should be introduced into the Polish tax system or in double tax treaties concluded by Poland are still in hand.

The Ministry of Finance explained that Poland is a member of the Developing a Multilateral Instrument to Modify Bilateral Tax Treaties OECD ad hoc group that developed during the course of the BEPS project, and whose objective is to speedily and consistently implement the proposal of new treaty provisions using the multilateral instrument. The Polish Ministry of Finance sees this initiative as an extremely important and effective means of combating tax avoidance and tax fraud and, therefore, Poland volunteered to participate in this group in April 2015. As a result, on 7 June 2017, Poland became a signatory to the Multilateral Convention to implement tax-treaty-related measures to prevent BEPS (MLI). Poland has reported 78 out of 89 double tax treaties to subject to the MLI. Given the fact

13 A response to the request for access to the public information lodged by the author to the Polish Ministry of Finance on 8 February 2016 (PK2.824.16.2016).
that the MLI has been recently signed, it may take some time to conclude the final scope of double tax treaties and the scope of their amendments. At this moment, it is too early to see or to predict the effectiveness of the above-mentioned measures.

The OECD places emphasis not only on the BEPS project, but also on the automatic exchange of tax information between Member States. Poland, as a member of the Early Adopters Group, has started exchanging information about the bank accounts of individuals. On 4 April 2017, a new Act on the exchange of tax information with other states came into force, which adapts Polish law to the requirements of the Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards the mandatory automatic exchange of information in the field of taxation. The Act’s main purpose is to bring together issues concerning the exchange of tax information in a single Act, including the implementation of automatic exchange of information on tax matters, also in respect of individual tax rulings at cross-border level and advance pricing agreements. The Act specifies, among others, the principles of mandatory automatic exchange of information in the field of taxation; the disclosure obligations of financial institutions regarding the exchange of information on bank accounts; the scope of exchanged information; the procedure for the notification; rules concerning reporting obligations; and the principles of due diligence of the financial institutions that are obliged to report.

The Act also provides regulations enabling the automatic exchange of tax information with third countries (outside the EU) under the Common Reporting Standard procedure. It should be stressed that Poland concluded a separate agreement on the exchange of tax information with the United States (the Foreign Account Tax Compliance Act (FATCA)). FATCA entered into force as of 1 December 2015 and its main aim is to impose an obligation on Polish financial institutions to obtain and exchange information with the tax authorities about US residents and citizens in Poland.

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INTRODUCTION

Although historically not a target country for wealthy individuals, Portugal has implemented structural reforms in recent years that have made the country one of the best all-round jurisdictions for high net worth individuals to relocate to.

Much of this success is down to the special programmes introduced to attract individual investors – the Golden Residence Permit Regime (allowing for free movement within the Schengen and the possibility to apply for Portuguese nationality) and the Special Tax Regime for Non-Habitual Residents – and the absence of wealth tax, gift and inheritance taxation on transfers between spouses, descendants or ascendants, exit tax, free remittance of funds and international trends (e.g., increase of fiscal pressure in some specific countries, tightening of access to traditional target countries, new global standards on automatic exchange of information). In addition, there is, of course, the reduced cost of living, public safety, healthcare system and climate, among other factors.

Recent progress in defining the tax regime applicable to the trusts and other fiduciary structures (a grey area until recently), also contributed to placing the country on the map of private wealth planning and foreign trust owners.

TAX

Personal income tax

An individual is liable to personal income tax (IRS) if he or she is deemed to be considered a resident in Portuguese territory, or, if not, if he or she derives income from Portuguese sources. Generally, a person is deemed to be considered tax resident subject to unlimited taxation if, in the year to which the income relates, he or she:

a. stays there for more than 183 days, whether these days are consecutive or not, in any 12-month period commencing or ending in the year concerned; or

b. has at his or her own disposal a dwelling place in such conditions that it may be inferred that there is the intention to keep and occupy it as a habitual abode.

Portuguese tax residents are subject to IRS on their worldwide income, on an unlimited liability basis. Non-resident individuals are subject to tax on the income obtained within Portuguese territory.
For IRS purposes, income is divided into six categories: A (employment income); B (business and professional income); E (investment income); F (real estate income); G (capital gains); and H (pensions).

Employment income, business and professional income capital gains from the sale of property and pensions are subject to a progressive income tax rate of up to 48 per cent. A surcharge applies to the part of the income exceeding €80,000, as follows: 2.5 per cent on the part of income exceeding €80,000 and up to €250,000; and 5 per cent on the part of income exceeding €250,000.

Investment income (such as dividends, royalties and interests), real estate income and capital gains derived from the disposal of securities (such as shares, bonds, etc.) are subject to taxation at an autonomous final rate of 28 per cent.

Among others, the following tax benefits may apply if certain conditions are met:

- income distributed by venture capital funds to individual unit holders is subject to a reduced final 10 per cent withholding tax, if not derived within the scope of a commercial, industrial or agricultural activity; and
- income regarding insurance policies, life assurance policies and pension funds schemes may be partially excluded from taxation whenever the amount of premiums, sums or contributions paid in the first half of the term of the contracts represents at least 35 per cent of the total.

ii Special tax regime for non-habitual residents

With the aim of attracting high net worth professionals, entrepreneurs and pensioners, Portugal has implemented an attractive tax regime for foreign individuals who wish to establish permanent or temporary residence in Portugal: the Non-Habitual Residents Tax Regime (NHR).

The major advantage of the NHR, and the one that makes it extremely attractive compared with similar regimes adopted in other European countries, consists of the introduction of a 10-year period during which Portuguese-source income received by individuals developing a high value-added activity is subject to a reduced flat tax rate, and foreign-source income, namely pensions, capital gains or business profits, may be fully exempt from tax, irrespective of remittance.

Specifically with regard to foreign-source income, the regime provides for a tax exemption if certain requirements regarding the type of income and taxation in the source state are met. These conditions are as follows:

- Employment income: the exemption will apply to foreign-source income if this is taxed in the source state in accordance with a double tax treaty entered into between Portugal and that state, or, if no tax treaty has been entered into between both states, the income is taxed in the source state and is not considered to arise in Portuguese territory according to the domestic criteria.
- Profits, interest, income from immovable property, capital gains, business and professional income arising from high value-added activities that are of a scientific, artistic or technical nature, and royalties: the exemption will apply if the income or gains can be subject to tax in the other state under a tax treaty entered into between Portugal and that state. Alternatively, if no tax treaty has been entered into between Portugal and the source state, the exemption applies if, pursuant to the rules of the Organisation for Economic Co-operation and Development (OECD) Model Tax
Portugal

Convention, interpreted in accordance with Portugal’s observations and reservations, the income or gains can be taxed in the source state, and provided that the income is not deemed to be sourced either in a blacklisted jurisdiction or in Portugal.

c Pensions: the exemption will apply if the foreign-source pension income is subject to tax in the source state in accordance with a tax treaty entered into between Portugal and that state or, alternatively, if the income is not considered to arise in Portuguese territory. Under this provision, both public and private pensions (other than pensions for public service) may benefit from total exemption from tax. This means that such pensions will not be subject to tax either in Portugal or in their state of origin in relation to a number of jurisdictions, including, for example, Austria, Belgium, China, Finland, France, Germany, Russia, Sweden and the United Kingdom. In some other states, this provision may grant a total exemption for private pensions only.

An individual is eligible to register as a non-habitual resident (up until 31 March of the year subsequent to the one in which he or she became a tax resident) if he or she:

a qualifies as a Portuguese tax resident pursuant to the Portuguese personal income tax code;

b has not been resident in Portuguese territory in the five previous years; and

c is able to present a foreign certificate of residence establishing that he or she has been subject to effective taxation abroad prior to his or her arrival in Portugal.

iii Inheritance and gift tax

The tax rate levied on gifts and inheritance is 10 per cent. A surcharge of 0.8 per cent of the taxable property value may be imposed on gifts or inheritance as far as they consist of real estate located within Portuguese territory.

However, there is no taxation on gifts or inheritance on assets not physically or legally located in Portugal at the time of death or donation, or transfers in favour of a spouse, descendants or ascendants.

iv Wealth tax

There is no wealth tax in Portugal. However, the identification number of bank accounts held abroad must be disclosed in the annual income tax return.

v Other taxes

The property transfer tax is levied on the onerous transfer of immovable property. The tax is payable by the acquirer, whether individual or company, resident or non-resident. The taxable amount corresponds to the higher of the contracted value or the tax patrimonial value.

The tax due is assessed as described above at the following tax rates:

a rural property – 5 per cent;

b urban property and other acquisitions – 6.5 per cent;

c urban property for residential purposes – progressive tax rates (ranging from zero per cent to 8 per cent); and

d rural or urban property when the acquirer is domiciled in a blacklisted jurisdiction – 10 per cent.
Local property tax is levied annually on immovable property located within each municipality. The tax is payable on the taxable value by the owner of the property as of 31 December of each year, to be paid in two instalments in the following year.

The taxable value of urban property corresponds to the tax patrimonial value inscribed in the tax registry and is determined by reference to correcting coefficients.

The property tax (IMI) rates are:

- a rural property – 0.8 per cent;
- b urban property – 0.3 per cent to 0.45 per cent; and
- c rural or urban property when the owner is domiciled in a blacklisted jurisdiction – 7.5 per cent.

The addition to IMI is levied on urban properties for dwelling purposes owned by individuals or companies, but individuals will not be taxed if the taxable value of its properties does not exceed €600,000. The tax rate is of 0.4 per cent in cases of properties owned by companies and 0.7 per cent for properties owned by individuals (increased to 1 per cent for the amount of taxable value exceeding €1 million). In contrast to this measure, the stamp duty levied on residential property with a taxable value higher than €1 million has been abolished.

vi Taxation of trusts

Despite not legally recognising trusts, Portugal has implemented the following rules on the taxation of trusts and other fiduciary structures:

- a the income accumulated in the trust during its lifetime is not subject to tax at the level of the settlor or beneficiaries, unless controlled foreign companies (CFC) rules apply;
- b distributions made during the lifetime of the structure, either to the settlor or to the beneficiaries, are considered as capital income for the full amount distributed (irrespective of its nature of capital or income) and are subject to a 28 per cent flat rate (that may be aggravated to 35 per cent in cases where the income is deemed obtained in a blacklisted territory); and
- c at the moment of liquidation, revocation or termination of the structure:
  - if paid to the settlor or founder, qualifying as capital gains, being the taxable income equal to the difference between the amounts delivered to the trusts and the amounts received as it happens with common corporations, and subject to a 28 per cent rate (aggravated to 35 per cent in cases where the income is deemed to have been obtained in a blacklisted territory); and
  - if paid to the beneficiary or beneficiaries, deemed as transfer for free (donation or inheritance) subject to stamp duty (flat rate of 10 per cent), even if, according to the territoriality principle laid down in the Stamp Duty Code, only the assets located within the Portuguese territory would be subject to tax.

vii CFCs

CFC rules were introduced in the 1990s, aiming to combat international tax evasion, notably by means of accumulation of profits in low-taxation territories. Basically, CFC rules provide for the inclusion, in the taxable income of the resident companies and individuals that control foreign legal entities deemed domiciled in a blacklisted jurisdiction, of the undistributed passive income received by such entities.
A relevant control shall be deemed to exist where the Portuguese-resident taxpayer holds, either directly or indirectly, a corporate interest equal to or exceeding 25 per cent of the shares, voting rights or equity rights of the foreign entity or its financial assets, albeit via an agent, nominee, trustee or other intermediary.

viii  Double taxation treaties

In addition to Portuguese domestic arrangements that provide relief from international double taxation, Portugal has entered into double taxation treaties with 79 countries to prevent double taxation, 76 of which are already in force.

Under these treaties, withholding tax rates on outbound dividend, interest and royalty payments are reduced wherever the beneficial owner of the income derived from Portugal is a tax resident of the other contracting state.

Portugal is a signatory to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, the implementation of which may impact on the application of the existing double taxation treaties.

ix  The US Foreign Account Tax Compliance Act

Law 82-B/2014 of 31 December 2014, which enacted the Portuguese budget law for 2015, approved a special financial information reporting regime, aimed at establishing the terms of the information exchange under the Foreign Account Tax Compliance Act (FATCA) agreement between the Portuguese and US tax authorities, including identification of the reporting entities, definition of reportable accounts, due diligence process for reportable accounts, information to be reported, timetable for reporting and penalties for non-compliance with the required information.

On 6 August 2015, Portugal and the United States concluded an agreement to improve international tax compliance and implement FATCA, which entered into force on 10 August 2016, after the fulfilment of its constitutional requirements.

III  SUCCESSION

i  General features

Portuguese succession laws have remained fairly unchanged over the years, partly owing to cultural reasons, as succession is deemed a right of the family members of the deceased in respect of a continuum principle (where possession is retained by the family).

As in most civil law jurisdictions, the Portuguese succession legal framework is complex and characterised by strong limits to the right of free disposition mortis causa of one’s property. Effectively, Portuguese succession law stipulates a forced heirship regime to protect the spouse, descendants and ascendants, ensuring these heirs from a third to two-thirds of the deceased’s total assets.

The portion of the inheritance (deceased’s estate) that is reserved for the legal heirs is generally safeguarded and cannot be affected by will or even (in most cases) by donations prior to death, as the assets could be reintegrated in the inheritance.

A distinctive feature about Portuguese succession is that the Portuguese regime only applies if Portuguese law is considered to be the personal law of the deceased at the time of death or will, independent of the location of the assets comprising the inheritance, both movable and immovable (universal succession).
For this purpose, Portuguese private international law stipulates that the deceased’s personal law is considered to be the law of his or her nationality at the time of death or at the time of the celebration of the will, being of utmost relevance for the determination of the law applicable to the succession and all its regulatory aspects of distribution and administration of the assets comprising the inheritance, and for the determination of the capacity for and the interpretation of the will.

As mentioned before, the Portuguese succession regime did not keep pace with regulation and social changes related to marital status, being largely irrelevant for succession purposes, *de facto* unions or civil partnerships and matrimonial property schemes adopted or prenuptial agreements, as none of these situations can affect the reserved portion or change the hierarchy of heirship.

The Portuguese Socialist Party recently presented to Parliament a draft law whereby a spouse married under the regime of separation of property may validly waive his or her capacity of heir to protect children of earlier marriages. This legislative initiative has been seen by large parts of civil society as the starting point for a wide-ranging debate about the dogmas surrounding succession issues. Further developments are expected to occur.

### Wills

In Portugal, the most common forms of will are the public will (which is drawn up by a notary and archived in the notary’s books, although remaining strictly confidential) and the private will (which is handwritten by the testator and its conformity with form requirements is then verified by a notary who issues the validation instrument).

Any of the said wills are freely revoked, with special requirements applicable to the public will, which need to be done by a public (i.e., not confidential) deed.

Portuguese law states that any will would be valid in Portugal if the material requirements of Portuguese law are met, the disposition does not offend or limit the reserved portion of the legal heirs and if it is compliant with the laws of at least one of the following jurisdictions:

1. The place where the will was concluded;
2. The personal law of the testator at the moment of the declaration;
3. The personal law of the testator at the moment of death; or
4. The jurisdiction to which the local conflict-of-law rules refer.

Although not as common as any of the said wills, it is also possible to conclude an international will, according to the Convention providing a Uniform Law on the Form of an International Will, concluded in Washington, DC on 26 October 1973.

Finally, according to Portuguese law – and as far as it is the applicable law – it is important to note the disposition by will of the deceased’s assets as the limit stated regarding the rights and the reserved portion of the inheritance of the legal heirs.

### IV WEALTH STRUCTURING AND REGULATION

The Portuguese succession regime is still very strict, leaving little room for the legal possibilities of estate planning. In addition, as most transfers on death are exempt from inheritance tax, and taxes levied on wealth are nearly non-existent in Portugal, no advance tax planning is necessary in most cases.

That being said, there are still some situations that may justify the structure of some legal entities (as private limited corporations or public limited companies) or civil entities. In
some cases, and for some specific and mostly altruistic purposes, it could also be justified to create a foundation, although in this case the creation and the activity of the foundation is subject to administrative approval and regulation.

Following the transposition of Directive (EU) 2015/849, Portugal has introduced a central register of beneficial owners, under which the individual person or persons who, whether directly or through a third party, own or effectively control entities with legal personality subject to Portuguese or foreign law, and who conduct activities or carry out acts or legal business dealings in Portugal, must be disclosed. Entities subject to the register include associations, cooperatives, civil societies and commercial companies trusts, and other fiduciary structures.

i Trusts
As a classic civil law jurisdiction, Portugal does not regulate trusts or recognise the existence of trusts regulated by foreign law, and does not even refer to such entities, with a few exceptional situations:

a to allow the incorporation of offshore trusts within the scope of the Madeira International Business Centre and regulate the corresponding tax effects;
b in the context of the tax treaties entered into with the US and Canada, acknowledging the trusts as possible resident entities in such states, strictly for the purposes of the application of the treaty dispositions, under certain circumstances;
c for anti-abuse purposes, to consider attributable to a Portuguese tax-resident individual the income obtained by entities domiciled in blacklisted territories irrespective of the distribution, in cases where the rights over the income are handled through a fiduciary entity; and
d to qualify the income arising from the distributions, liquidation, revocation or termination of the trust.

One consequence of this legal vacuum is that a Portuguese settlor who sets up a trust must respect Portuguese mandatory heirship rules. Any infringement of these rules can be challenged by the heirs of the settlor, and the assets transferred to the trust may be reduced accordingly.

ii Life insurance policies
As Portugal has become a very popular retirement location for foreigners, life insurance is proving to be an attractive wealth-planning tool, thanks to the flexibility granted to the policyholder (allowing for partly redeeming the policies, changing the beneficiaries and, in some cases, intervening in the management of the portfolio), high level of assets protection, and the very advantageous tax regime. From an income tax perspective, taxation of income generated in an individual's life insurance is deferred and should only be taxed in the event of redemption, early payment, or maturity of the policy. Tax could only be levied on the net income generated by life insurance. The Portuguese personal income tax law establishes that provided that at least 35 per cent of the insurance premiums contractually due were paid during the first half of the contract's lifetime:

a only four-fifths of the income received is subject to personal income tax (meaning an effective tax rate of 22.4 per cent) if the payments are made under contracts that have been in force for more than five years and less than eight years; and
only two-fifths of the income received is subject to personal income tax (meaning an effective tax rate of 11.2 per cent) if the payments are made under contracts that have been in force for more than eight years.

V OUTLOOK AND CONCLUSIONS

As a result of the tax reforms and programmes undertaken over the past few years, and other factors relating to economic, social and lifestyle aspects, Portugal is currently an extremely appealing country for wealthy individuals to have a foothold in, competing in this respect with other countries traditionally chosen for wealth-planning purposes. The NHR, along with the visa programmes, represented a major step forward, allowing for those who become tax resident in Portugal and are accepted as non-habitual residents the opportunity to receive qualifying income tax-free, both in Portugal and in the country of source under proper planning.

From a macroeconomic perspective, GDP growth is expected to ease slightly but should remain strong in 2018 and 2019 (at around 2 per cent), mostly supported by employment and consumption growth, inbound investment and favourable external trade conditions.

Despite some recent developments in the composition of the government (whose effects were felt in the increase of the taxation of land and real estate), the political situation remains stable and there is not expected to be any relevant shift in the commitment of the main political forces to ongoing reforms of the tax and labour regimes, and to the strengthening of the current path of growth.
I INTRODUCTION

The Spanish tax network follows the same standard principles as the main jurisdictions of continental Europe. Marginal tax rates on income are high, but capital gains taxation is more moderate. There is also a wealth tax for passive savings beyond a certain figure. Finally, in some regions there is an aggressive inheritance and gift tax policy.

Investors from all over the world invest in Spain, and cross-border taxation is designed following standard European terms. Spain has signed 94 double tax relief treaties that follow the Organisation for Economic Co-operation and Development (OECD) model, and older treaties are being renewed. A new tax treaty with the US is still pending full ratification, as at the time of writing. There are also three inheritance tax treaties in force in Spain.

Spain is not an attractive jurisdiction for wealth from a tax perspective. Having said that, there are significant differences in taxation in the different regions of the country. Therefore, the city of residence within Spain will also be an important factor in determining the total tax burden. There are still a lot of safe tax planning structures that can mitigate or protect wealth from this formally aggressive environment. There are important tax-saving advantages for business-oriented wealth, and there are some basic tax planning ideas that can reduce the tax burden for passive wealth.

Several tax compliance and reporting obligations have been introduced lately, in line with EU and OECD trends. For individuals, tax residents must annually inform the authorities about all foreign assets exceeding €50,000.

Trusts and other similar fiduciary agreements are not accepted inter vivos in Spain. Spanish law applies forced heirship restrictions only to Spanish nationals. However, with the new EU ruling for the harmonisation of inheritance law within Europe, the country of residence prevails if there is no will that sets nationality as a preference.

Overall it can be said that the Spanish tax environment for wealth is formally aggressive and complex, following conventional standards, but there is scope for legitimate planning.

The Spanish tax administration is highly dependent on computer systems and the internet, and companies now only deal with tax compliance via the internet.²

In the past years, and owing to the government effort to comply with EU deficit limitations, the administration has frequently changed some of the relevant tax laws to improve collection. Nevertheless, the general tax framework has not changed.

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1 Pablo Alarcón is the founding partner of Alarcón Espinosa Abogados.
2 The gateway for tax information, compliance and other tax services is www.agenciatributaria.es.
A new, important tax reform was introduced on 1 January 2015. The reform reduced the nominal tax rates for individuals (both the standard rate and the capital gains and savings income tax rate), introduced several tax advantages for lower-end taxpayers, and included a variety of benefit limitations and anti-avoidance measures.

Among the new measures that may have an impact on individual wealth tax planning are the following:

- **a** a new exit tax for individuals with significant holding interests in companies or qualified funds (UCITS) in Spain that leave the jurisdiction to become tax-resident elsewhere;
- **b** a more restrictive definition of the controlled foreign corporation rules, which will make it more difficult and tax-expensive to hold and control foreign companies that conduct no trade and have no substance, even within the EU;
- **c** old coefficients that reduced the tax on part of the nominal capital gains because of inflation have been removed so there are no longer inflation correction coefficients for gains;
- **d** the tax reduction for irregular income has been lowered from 40 to 30 per cent;
- **e** redundancy compensation paid to employees (above a minimum level of €180,000) is taxed. Prior to mid 2015, such payments were tax-exempt up to the legal maximum; and
- **f** non-resident standard tax rates have been reduced for EU residents from 24 to 19 per cent.

Some further changes are commented upon below. Important changes that were intended to be made to inheritance and gift tax and wealth tax have been postponed but will likely come sooner rather than later. Further, a recently formed government may introduce relevant tax measures in the following year, specifically addressed to large corporations and wealthy individuals to increase tax collection.

## II TAX

### Personal taxation

Spain’s official tax year runs from 1 January to 31 December. An individual will be tax-resident in the country for full year periods. Income tax returns must be filed by 30 June in the year following the tax year.

Under income tax law, individuals are tax-resident in Spain if they have lived in Spain for more than 183 days in any calendar year; and most of their income or wealth, or both, is generated from Spanish sources (this is presumed to be the case if their spouses or descendants are habitually resident in Spain).

Spanish tax residents are liable to Spanish taxation on a worldwide basis. There is no concept of domicile in Spanish tax law, and Spanish nationality has no tax relevance.

### Personal taxation for tax residents

Personal income tax forms the backbone of Spain’s tax system, and it mainly falls on salary income. A standard withholding tax procedure collects taxes from payroll and other sources of income.

After several years with marginal rates beyond 50 per cent, marginal rates for 2016 and onwards have now been set at 45 per cent. However, the different regions are able to reduce or increase the rate via tax credits.

Capital gains and savings income are taxed at a marginal rate of 23 per cent since 2016. Capital gains can be compensated against losses, and the latter can be carried forward for
four years. In the case of real estate, the gain in the sale of one's residence is tax-exempt if the proceeds are reinvested in another property to be used as the primary residence. Individuals over 65 years old selling their residence will not pay capital gains tax so do not need to reinvest proceeds.

A special tax on gains from lotteries applies at a rate of 20 per cent.

There is no capital gain tax burden on inheritance. Beneficiaries of an estate will receive the assets up to market value, and will only pay inheritance tax.

High-ranking executives and other professionals can reduce a small part of their tax burden with certain limited payments in kind, exemptions on work performed abroad and, in some circumstances, up to 30 per cent of the tax on deferred bonuses that has been vested for more than two years. However, these benefits are all capped and will never imply a significant tax saving.

For passive wealth, the basic strategy is the deferral of taxes. Investment in UCITS has a favourable tax treatment since the sale and reinvestment of proceeds from one fund to another will not trigger tax and the capital gain is deferred until the funds are withdrawn or invested in other assets. This tax deferral requires a Spanish trading entity to deal with this reinvestment process and to report to the tax authorities.

Wealthy families can also hold their own investment companies (SICAVs) following the UCITS model, and can reinvest proceeds within the entity with only a 1 per cent tax on profits or gains realised. Other financial products, such as savings insurance policies or life annuities, can be structured in tax-efficient ways.

Spanish tax residents must declare and pay wealth tax, which is levied on the value of worldwide net wealth exceeding €300,000 for a personal home and possessions and €750,000 on other assets. Madrid is the only region not subject to this tax. The marginal rate, depending on the region, will be between 2.5 and 2.7 per cent above €10.7 million.

This can be a significant yearly burden for wealthy taxpayers. However, private wealth that is included in a family company is not subject to wealth tax; thus, most family businesses are structured in a way so that investments fall under the same umbrella as the active business. For passive wealth, there is a general limitation of combined tax (income tax plus wealth tax) that cannot exceed 60 per cent of total income (excluding capital gains) for the year. The best strategy is, therefore, not to live on income but on the returns of investment capital. Following this strategy, wealth tax can be reduced to a minimum rate of 20 per cent of the standard tax bill.

Recent positive rulings and judgments provided more legal certainty for life insurance policies, with no redemption right as an investment vehicle to legally avoid wealth tax.

As a result of this and other tax-saving strategies, wealth tax does not collect much money, and only professionals and top executives are being hit by this levy, which was created in 1977 in a totally different economic environment. It has an obsolete framework, tax rates are very high compared with market interest rates in the past years and it is highly criticised by most technical commentators.

**Personal taxation for non-tax residents**

Non-tax residents are only taxed on Spanish-sourced income. The standard rate is 24 per cent (for EU residents the rate is 19 per cent), and the rate for interests, dividends and capital gains, provided that no treaty is applicable, is 21 per cent (for EU residents the rate is 19 per cent).

In most circumstances, taxation of non-resident individuals in Spain is ruled by one of the tax treaties that Spain has signed, which mostly follow the OECD model.
An interesting tax regime is available for non-resident individuals coming to Spain. According to this regime, such individuals are taxed as if they were non-resident on their Spanish-sourced income and foreign labour income as well as non-resident rates of tax. The relevant individuals should have either a labour agreement or appointments as directors in place that are applicable in Spain. Individuals benefiting from this regime are still deemed to be tax-resident in Spain. The regime applies for a maximum of €600,000 per year and for five years plus the remainder of the year in which the individual arrived in Spain. This special regime is no longer available for incoming sportspeople and performers.

A new exit tax that has been introduced in Spain follows principles similar to those found in the French and German exit tax regimes, and is levied on assets exceeding €4 million. It has been adapted to the requirements set by the European Court of Justice not to create conflict with the principle of freedom of movement of persons within the EU.

There are pre-immigration tax planning ideas that could reduce or even eliminate the yearly tax burden of incoming individuals living on passive income.

Non-residents are also subject to Spanish wealth tax on their personal assets that are located in Spain or that can be exercised in Spain. For instance, if they own a property in a region that levies wealth tax, they will pay such tax provided that the value of the property exceeds the minimum exemption threshold of €750,000.

There is no wealth tax for corporations, so an easy way to circumvent this issue in the case of large property investments is to carry out such transaction through a foreign company.

ii Gift and succession taxes

In Spain, gift and inheritance tax is on beneficiaries and not on the gift or estate level.

Spanish tax residents (based on the same principles as above) will be liable on all gifts or benefits received from inheritance, regardless of the location of the assets or the residence of the deceased. Non-tax-resident individuals will only be liable to Spanish inheritance and gift taxation for Spanish-situated assets.

There are no general tax-free allowances. Special and limited allowances are applied to the mortis causa transfer of the home or the mortis causa transfer of wealth to minors.

There are very important differences regarding the effective taxation of gifts and inheritance for first-degree transfers of wealth, meaning spouse, parents and grandparents to siblings and grandchildren, and vice versa.

In regions such as Catalonia, La Rioja, Madrid, Navarra or the Basque region, there is a very significant tax reduction on first-degree transfers of wealth, both inter vivos or mortis causa. This tax advantage is also applicable to beneficiaries resident within the European Union.

The tax saving of this benefit can be substantial, since the marginal tax rate goes up to 34 per cent for transfers above €680,000.

In certain circumstances, transfers of family business within the family in any region can benefit from a 95 per cent tax reduction, because the family is not obliged to sell or mortgage the business to be able to pay a tax bill. The beneficiary must continue the business (or retain the shares) for at least 10 more years (five years in some regions).

For transfers to nephews, nieces or cousins, the rate can jump to 50 per cent, and for third parties it can go to up to 68 per cent. As such, in the case of inheritance falling outside the immediate family, it is paramount to study other alternatives that could reduce the tax bill.

Each beneficiary is liable for inheritance or gift tax on the value of the share of the estate received according to his or her personal circumstances.
For tax purposes, there is no significant difference between gifting assets during one’s lifetime or by will; both are taxed on the same principles. However, it should be remembered that a gift in kind (for instance, a property) will also trigger capital gains taxation on the donor, while for *mortis causa* there is no capital gain taxation, although the assets are received by beneficiaries with a step-up to market value.

There is a municipal capital gains tax on the transfer of real property located in Spain, which is also payable on death and on lifetime gifts. This municipal capital gains tax is based on the cadastral value of the land and the length of time that the property was held by the transferor and, according to recent judgments, should only be levied in the case of realised gains (and not in case of a loss) from the sale of the property. This tax is deducted from the tax basis of inheritance and gift tax.

Finally, it should be noted that trusts are an alien concept to the Spanish legal system. Spain has not even signed the Hague Convention for the Recognition of Trust Consequences. The tax authorities have adopted a very negative stance on trusts, with the exception of plain trust wills.

The most common approach taken by the Spanish tax authority is to ignore the trust and deem the assets to be still in the hands of the grantor or settlor, even in the case of irrevocable trusts. Plain trust wills that are wound up together with the distribution of the estate are deemed normal wills.

In any other situation, the Spanish tax consequences are unpredictable; therefore, it is of paramount importance to review the case if there are Spanish assets involved or if Spanish tax residents are beneficiaries to a foreign trust.

The complex and uncoordinated inheritance tax framework that exists throughout Spain is being discussed at the time of writing. It is likely that a minimum coordinated tax rate will be set for all regions, and that each region will set its own rules regarding this, although never allowing the total tax burden to fall below the minimum coordinated rate.

### iii Issues relating to cross-border structuring

In terms of cross-border structuring, two situations merit some thought. First, pre-immigration planning is necessary for wealthy non-Spanish tax residents coming to Spain. Considering the personal situation of such person and the nature of his or her wealth, several pre-immigration steps could be taken to create a safe tax structure under which he or she would be able to live in Spain with a limited tax burden. As previously mentioned, the key is living on returns of capital instead of income.

Second, investors in Spain, and especially in real estate property, can be misled by offers of cheap offshore structures that are no longer viable. If the property is worth enough, there are legitimate ways to mitigate future capital gains tax on the sale of the property and legally avoid Spanish inheritance tax risk, such as holding the property through a double corporate structure with the main holding company being a non-Spanish resident company.

### iv Regulatory issues relevant to high net worth individuals

Most of the highest net worth individuals or families are the first or the second generation of a family business, and most high net worth individuals have their own close personal advisers. These are very often tax experts, and at the higher end they often have a family office to deal with investment issues outside of the family company. Private banks and special units of retail banks also often manage most of the investments of high net worth individuals and families.
As previously mentioned, an important part of the financial investments of wealthy families is wrapped up in SICAVs, which are collective investment vehicles in listed securities that only pay 1 per cent tax on net income. The use of SICAVs by such wealthy families will probably be limited in the near future.

Independent financial advisers are also a reality in the Spanish market, but are not as widespread as they are in other countries because of the regulatory requirements and compliance burdens involved in obtaining and retaining a licence.

It must be highlighted also that the tax authorities are intensifying tax inspections of high net wealth individuals and families (including top sportspeople and entertainers) and are challenging the aggressive tax planning strategies that some of them have in place.

v Issues affecting entrepreneurs

In Spain, as in most of Europe, wealth that is invested in a family business will generally be protected; it will not be subject to wealth tax, and profits will not be taxed unless they are distributed.

A simple holding company would avoid double taxation of profits within the group, and profits can be reinvested without further taxation until they are paid out to individual investors.

A visa residence permit is available for foreign investors and entrepreneurs under several investments requirements.

III SUCCESSION

In Spain, forced heirship regulations apply only to Spanish nationals. However, with the new EU ruling for the harmonisation of inheritance law within Europe, the country of residence prevails if there is no will that sets nationality as a preference. Hence it can be paramount for a foreign permanent resident to formalise such will since otherwise he or she could be caught by forced heirship provisions of Spanish inheritance law.

Under the forced heirship regime, two-thirds of a person’s total assets must be distributed between the forced heirs (direct descendants, direct ascendants (if there are no descendants), spouse).3 Out of this two-thirds with restrictions, one-third of the estate must be distributed equally among the forced heirs, and the remaining third can be used to improve the conditions of any of them. The spouse has the right to receive a life interest (usufruct) in the assets comprising the compulsory one-third share received by the descendants under the forced heirship regime.

A third of a person’s estate can be freely distributed by will.

There are some regions where the forced heirship regime does not apply or is modified, such as Navarra (where there is no forced heirship regime), the Basque region and Catalonia (where there are specific rules than can partly override the forced heirship regime). If the deceased is a Spanish national from outside the above-mentioned regions, the forced heirship regime cannot be avoided. The general rule is that the forced heirship regime applies to all distributed assets, regardless of the beneficiary’s residence.

The forced heirs can waive the right to receive their share, or propose a different distribution of the assets subject to the other forced heirs’ rights under the regime.

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3 Each category precludes those subsequent from receiving a share of the deceased’s estate.

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For Spanish nationals, matrimonial law will be the law of the first residence of the couple. Non-Spanish nationals will be ruled by the law of nationality and, if this is not definitive, the law of the residence of the couple.

The economic terms of nuptial and prenuptial agreements for the administration of the family are generally accepted by the Spanish courts if they follow the principles of the law of the jurisdiction in which the couple lives.

IV WEALTH STRUCTURING AND REGULATION

As previously mentioned, trusts are not recognised in Spain, and their effects cannot be imported into Spain.

From a tax perspective, if a trust is operating with Spanish assets, the tax authorities will probably ignore the trust and allocate the assets to the grantor or settlor even in the case of irrevocable trusts. However, there are no clear and uniform criteria from the tax authorities in this regard; therefore, trusts should not be used for tax structuring purposes in Spain.

Regarding family law, claims against trust assets by the spouse or civil partner of a settlor or beneficiary on the dissolution of a marriage or partnership must be filed in another jurisdiction, as Spain does not recognise trusts.

Private foundations are also not possible in Spain. All foundations should have an object of public benefit and should be supervised by the relevant public authority. Foundations are the typical legal form of charities in Spain.

Foreign private foundations are also ignored by the tax authorities except when they are the substitute for a will, in which case they could be treated as such.

Partnerships are recognised and treated as tax-transparent vehicles. They are frequently used for handling shared property and for international business ventures. Family partnerships are also common in family businesses with multi-jurisdictional partners.

However, the most common vehicle for all business purposes in Spain, including family businesses, is the limited liability company. The limited liability company follows the general principles of companies with shares in which voting rights are linked to shareholding percentage. They can be used directly as business entities or as holding entities owning the shares of a group of companies.

A holding company acting as head of a group of subsidiaries is also common practice. This structure permits an easier formation of voting majorities for the whole group, and at the same time helps reinvestment of profits all over the group through the holding company and thus defer taxation of such profits at the level of the shareholders.

If the business group also holds interests in foreign companies, it can also be established as a foreign securities holding company, which is a special tax status for entities with qualified foreign shareholdings that can provide tax advantages to its shareholders on foreign dividends or foreign portfolio gains.

In Spain, there are strict anti-money laundering provisions following EU directives and international guidelines. All practitioners, bankers, attorneys, notaries and authorised wealth managers are bound by strict compliance regulations, and are thus obliged to keep records of clients’ identities and activities, including the source of their wealth.

There is also an obligation to report to the Bank of Spain any operation that could be suspicious of involving money laundering, with the exception of matters protected by lawyer–client privilege when defending a client before the courts.
V OUTLOOK AND CONCLUSIONS

For several reasons that are unrelated to tax, Spain has been an attractive country in which to live or to invest in real estate property. Taxes in Spain have been high, following European standards, for the last 20 years, but there has always been scope for legitimate tax planning that has mitigated the Spanish tax burden for well-advised incoming residents or investors.

The extraordinary tax situation that existed in Spain in the past few years – with the high national tax rates that applied to most taxable income during 2012, 2013 and 2014 – has changed since 2015, when there was a reduction in tax rates (an average reduction of 7 per cent on marginal rates) that has had an impact on most taxpayers.

However, the benefits that have been gained from the reduction in the national tax rates have to some extent been offset by the introduction of several important reductions in the tax benefits that were available before and with a more aggressive wording of the anti-avoidance provisions, both of which have created a more complex landscape for tax planning in Spain.

Tax collection efforts focus more on both domestic and multinational large corporations that have used and abused the tax law with very aggressive tax-leveraged structures and extreme transfer pricing policies. Corporation tax has recently been subject to a variety of measures to reduce the list of tax-deductible expenses, and there have also been significant reductions in most of the tax credits that have been available to date.

Under a tax amnesty that took place in 2012, individuals holding non-declared assets could disclose these assets subject to a very low tax payment of 10 per cent calculated on the yield or gain obtained on such assets during the past four years. However, non-compliant wealthy individuals living in Spain may have a difficult time in future years. Exchange of information and cooperation agreements for international tax collection are now a reality and it is futile to hide wealth abroad or to ignore unpleasant tax laws. Spain has signed a Foreign Account Tax Compliance Act agreement with the US for the automatic exchange of information on tax-resident individuals or US citizens and foreign financial investments.

Tax residents in Spain must disclose all foreign assets to the tax authorities every year; failing to do so could give rise to large penalties beyond the value of the hidden assets, and the forced incorporation of undeclared assets may lead to relevant tax assessments that could result in a tax crime, punishable by up to six years in prison.

Overall, Spain follows the trend of the conventional jurisdictions of Europe, where taxes on the generation of wealth are significant but where living on passive income can be subject to efficient tax planning.
Chapter 36

SWITZERLAND

Mark Barmes, Frédéric Neukomm and Heini Rüdisühl

I INTRODUCTION

Switzerland has long been an attractive destination for wealthy individuals and families. Many reasons can be advanced for this: neutrality and political stability; its status as a safe haven; its central location within Europe; its reputation for high service standards; its role as a key player in the custody and management of private wealth; and its system of taxation and bank secrecy.

Since the turn of the century and the growth of globalisation, Switzerland has been faced with a new world order and accelerating internal and external demands for change. Recurrent incidents of data theft in banks, the well-publicised litigation in the United States involving UBS, the financial crisis and ever-increasing multilateral demands for automatic exchange of information have contributed to produce a breathtaking rate of change.

In this context, the Swiss government has at times seemed overwhelmed. However, if one pauses to look at all that has and will be done, it is notable that the quintessential Swiss characteristics of democracy, negotiation and healthy obstinacy are producing positive results.

In particular, now that the switch to exchange of information in tax matters has been accepted globally, there are encouraging signs that Switzerland remains a destination of choice for wealthy individuals and for the custody of private wealth. Switzerland’s status as a safe haven now holds centre stage. This seems largely due to the significant efforts of the government to assemble the framework, tools and skills to manage private wealth in a transparent digital economy, without losing sight of the individual or respect for the rule of law.

II TAX

i The federal tax system

Switzerland is a federal state consisting of 26 cantons. Income tax is levied at the federal, cantonal and municipal levels, while wealth tax and gift and estate tax are levied at the cantonal and municipal levels only. The cantons are competent to assess and collect most direct taxes, including federal income tax.

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1 Mark Barmes, Frédéric Neukomm and Heini Rüdisühl are partners in the private client practice group at Lenz & Staehelin.

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The rules for assessment of income and wealth are widely harmonised by federal law. Consequently, the cantons impose cantonal tax using the same basis as for the federal tax, except for certain minor rules (e.g., social deductions). The cantons are competent to set their tax rates, and the municipalities generally set their tax rate by reference to the cantonal tax rate.\(^2\)

Switzerland is not a low-tax jurisdiction for ordinary taxpayers. Switzerland may, nevertheless, be fiscally attractive for high net worth individuals because it offers low tax rates in certain municipalities, an exemption from capital gains on movable assets and reduced taxation of dividends.

The other advantages are the well-established ruling practice that allows individuals and businesses alike to discuss in advance the tax treatment of certain transactions or structures and the lump sum tax regime for foreigners who do not engage in any gainful activity.

ii Personal taxation

Income tax

Switzerland taxes Swiss residents on their worldwide income except for income derived from a foreign trade or business or real estate located abroad. Non-residents are taxable if they own businesses or real property in Switzerland, or if they receive employment income from a Swiss employer or director fees from a Swiss company.

Capital gains exemptions

Capital gains on movable assets, such as shares in companies or works of art, are not taxed if the gain results from the sale of private assets as opposed to business assets. Business assets are assets that are related to a business located in Switzerland.\(^3\)

Capital gains on real property located in Switzerland are exempt from federal income tax if the property is part of an individual’s non-business or private assets. Such gains are subject to a cantonal and municipal property gains tax. The applicable tax rate varies greatly depending on the canton and on the duration of the holding of the property. Rates generally vary between zero per cent for very long holding periods and 30 per cent, but can be as high as 60 per cent in the case of a short holding period.

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\(^2\) Tax rates are generally progressive. The maximum federal tax rate is 11.5 per cent, and maximum cantonal and municipal tax rates vary between 7.1 per cent (canton of Schwyz) and 34.3 per cent (canton of Geneva). The overall income tax rate can thus be comprised between 18.6 and 45.8 per cent. Similarly, the maximum wealth tax rates vary between 0.1 per cent (canton of Schwyz) and 1 per cent (canton of Geneva). The tax rates are generally higher in the French-speaking part of Switzerland and in the urban areas (Zurich, Basel, Bern, Lausanne, Geneva).

\(^3\) The concept of business has, however, been interpreted extensively by the cantonal tax administrations and the Swiss Supreme Court. They consider an independent business activity may exist where a taxpayer acts in a professional manner, for instance, by systematically trading in securities. This extensive interpretation led to uncertainty, and safe-haven rules have been published by the Swiss Federal Tax Administration.
**Dividend taxation**

Dividends from qualifying participations of at least 10 per cent are more favourably taxed. For federal income tax, a 40 per cent tax relief is granted for participations held as private assets so that only 60 per cent of the dividend income is subject to taxation. The incentives granted at cantonal level vary from canton to canton.4

**Wealth tax**

Cantons and municipalities levy wealth taxes on worldwide net assets,5 except for real estate abroad. The majority of the cantons apply progressive tax rates and maximum rates vary between 0.1 and 1 per cent.6 In the cantons that have high wealth tax rates, wealth tax can have a significant impact on the overall tax burden, and tax structuring or pre-entry tax planning is sometimes advisable.

**Lump sum**

The ‘lump sum’ or ‘flat’ tax system in Switzerland opens the possibility for foreign citizens resident in Switzerland to pay their taxes based on a lump sum, subject to certain minimum criteria.

Foreign citizens who come to live in Switzerland for the first time (or after an absence of 10 years) and who do not engage in any gainful activity in Switzerland may, upon request, be taxed on a lump sum basis for cantonal and communal income, net wealth and federal income tax purposes. A limited professional activity can be carried on outside Switzerland.

Under the lump sum arrangement, tax is levied on the basis of a deemed income based on the annual living expenses incurred in Switzerland and abroad by the taxpayer and his or her family.7

The tax due on the agreed tax base is calculated on the basis of the ordinary income and net wealth tax rates applicable to that agreed tax base.

In any event, the tax due must not be less than the taxes determined in a ‘control calculation’ under which certain specific Swiss-sourced items (e.g., income and wealth from real estate situated in Switzerland or securities issued by companies domiciled in Switzerland) are aggregated. The ultimate tax payable is the higher amount determined by the control calculation and the agreed flat tax. The lump sum tax system applies only to income and net wealth tax, not to inheritance taxes.

The lump sum tax system has been subject to political discussion in the past, and the canton of Zurich and four other cantons abolished the lump sum tax system for cantonal and municipal taxes, while other cantons tightened their conditions. Under the new federal legislation, the minimum amount of taxable income is calculated by multiplying the rental value of the real estate owned by the taxpayer (respectively the rent paid) by seven, with a

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4 Most cantons apply a relief similar or comparable to the federal tax relief, but certain cantons apply a reduced tax rate on the dividend income with a reduction that can be as high as 75 per cent (canton of Schwyz) and result in a tax rate on the dividend income of 8.8 per cent (canton of Schwyz).

5 Market value of the assets minus debt.

6 Certain cantons allow further deductions. Recently, certain cantons have also introduced a ‘wealth tax shield’ to reduce the wealth tax payable by individuals who have a proportionally low taxable income.

7 At present, such annual expenditure figure may not be less than seven times the annual rent paid for the main accommodation occupied by the taxpayer and his or her family, or, if the taxpayer owns his or her own accommodation, seven times the deemed rental value of that property.
minimum tax base for federal tax of 400,000 Swiss francs. An initiative from left-wing parties calling for the abolition of the system was rejected by 69 per cent of the Swiss voters in 2014. Following this vote, political discussions came to an end and the system is not challenged any more.

**Withholding tax**

Switzerland applies a withholding tax of 35 per cent on dividends, interest from bonds issued by Swiss residents and interest paid by Swiss banks. This tax is fully refunded to residents who declare their income in their tax return, and can also be partially or totally refunded to foreign residents subject to international tax treaties. Because of this withholding tax, tax planning is often needed for foreign-resident individuals who wish to incorporate holding structures in Switzerland.

**iii Gift and estate tax**

At the federal level, there is no gift and estate tax, but at the cantonal level, gift and estate tax is levied by most cantons, with the exception of the canton of Schwyz. Tax jurisdiction normally lies with the canton of the last domicile of the deceased, respectively the donor. Where the deceased has his or her final domicile in Switzerland, the entire worldwide estate, with the exception of foreign real property and assets belonging to a foreign permanent establishment, is subject to Swiss estate tax. Swiss real property and Swiss businesses that are the subject matter of a gift or a bequest can give rise to Swiss gift and estate tax even if the donor or the deceased was not Swiss domiciled.

The scope of the gift and estate tax varies greatly among cantons. The surviving spouse is exempt from estate and gift taxes in all cantons. All cantons, except Vaud, Neuchâtel and Lucerne, exempt gifts and bequests between parents and direct descendants. The tax rates on gifts and bequests, which are generally progressive, vary greatly depending on the relationship between the parties and the canton. The tax rate may be as high as 55 per cent in the event of a gift or bequest to an unrelated person.

An initiative by left-wing parties calling for the introduction of a 20 per cent federal gift and estate tax on estates and gifts worth more than 2 million Swiss francs was rejected by 70 per cent of the Swiss voters on 14 June 2015.

**iv Exchange of information, withholding tax on banking assets and FATCA**

Until March 2009, Switzerland's treaty network did not provide for exchange of information to internationally agreed standards, as information exchange was generally limited to exchange for the purposes of the application of the treaty. In some treaties with Organisation for Economic Co-operation and Development (OECD) and EU Member States, Switzerland also provided for exchange of information in cases of tax fraud and acts of similar gravity.

In practice, the actual tax basis is determined by an advance ruling from the tax administration of the canton in which the individual wishes to take up residence. In the majority of cantons there is a practical minimum tax base (threshold) or an amount of tax, even if the expenses as determined above are less than this amount.
On 13 March 2009, the international standard on information exchange for tax purposes was adopted by Switzerland, and the country has moved rapidly to update its bilateral treaties.8

On 27 May 2015, Switzerland and the EU signed an agreement regarding the introduction of the Common Reporting Standard (CRS). It entered into force on 1 January 2017.

Parallel to this, work continued on introducing the legal basis and statutory framework (law, ordinance and directive) to implement the CRS in Swiss law.

Switzerland and foreign partner states and territories will exchange information automatically based on the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information (MCAA). The MCAA in turn is based on the OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters (administrative assistance convention). Both the administrative assistance convention and the MCAA entered into force on 1 January 2017 together with the Federal Act on the International Automatic Exchange of Information on Tax Matters. The first exchange of data will be in calendar year 2018.

At the time of writing, the framework for the automatic exchange of financial account information is in place, among others, for the 28 EU Member States, and Barbados, British Virgin Islands, Canada, China, Guernsey, Iceland, the Isle of Man, Japan, Jersey, Korea and Norway.

Following the enactment of the Foreign Account Tax Compliance Act (FATCA), Switzerland decided to implement Model 2, which means that Swiss financial institutions will disclose account details directly to the Internal Revenue Service (IRS) with the consent of the US clients. The agreement between the United States and Switzerland for Cooperation to Facilitate the Implementation of FATCA was signed on 14 February 2013, and Swiss implementing legislation entered into force on 30 June 2014.

III SucCeSSion

The Swiss inheritance law system is based upon the idea that the community of heirs (community) steps into the deceased's shoes immediately upon his or her death.9 The assets and liabilities of the deceased vest automatically in the community, the heirs becoming joint owners of the deceased's estate and joint debtors of the deceased's debts. The appointment of a testamentary executor (through testamentary provision) or of an official administrator (through a court decision) is possible, but such person will not be considered to be the owner of the assets of the estate, but merely as limiting the heirs' possession of such assets until partition.

Even though Switzerland recognises testamentary freedom to a certain extent, Swiss successions are based upon a system of statutory devolution of the estate (in the absence of a will) allowing the testator to modify such system to a certain extent by will, but also limiting testamentary freedom by protecting some of the statutory heirs with forced heirship rights. The primary heirs are the descendants,10 together with the surviving spouse or registered

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8 As of 20 June 2018, there were 53 treaties with the international standard in force.
9 Article 560 of the Swiss Civil Code (SCC); 'le mort saisit le vif'.
10 Article 457(1) of the SCC.
partner. In the presence of descendants, the surviving spouse or registered partner is entitled to 50 per cent of the estate (the descendants having to share the other 50 per cent per capita). In the absence of descendants, the parents (or their descendants) will be heirs (if there is a surviving spouse or registered partner, the latter will be entitled to 75 per cent of the estate).

Some of the statutory heirs are protected by forced heirship rights. Descendants are entitled to a compulsory share of 75 per cent of their intestate entitlement; a surviving spouse or registered partner and parents are protected up to 50 per cent of their intestate share; other statutory heirs are not protected. The portion of the estate that is not encompassed by the compulsory shares can be freely disposed of by the testator and is usually called the freely disposable share.

Forced heirship rights may also protect the heirs against inter vivos acts, in particular revocable transfers and transfers made within five years of the time of death, as well as transfers made with the object of depriving the heirs of their protected rights.

The heirs may leave the infringing testamentary provision or inter vivos transfer unchallenged. The protection merely entitles them to claim their rights (either by asserting a claim against the will or against the holder of the assets within a certain time limit and provided that certain conditions are met) or to oppose the delivery of assets held by the community to the person benefiting from a testamentary provision.

By testamentary provision, the testator may designate given persons as heirs, entitle others to legacies, appoint an executor, set up a foundation, or request an heir or a legatee to do something. The question of whether a testamentary trust could validly be set up within the framework of a succession governed by Swiss inheritance law is disputed, even if the current trend seems to be favouring such a possibility.

Besides the unilateral will, which has (under Swiss domestic law) to be written entirely by hand or executed in front of a notary public (and, to a very limited extent, can be made orally), Swiss inheritance law also recognises the possibility of entering into inheritance

11 Article 462(1) of the SCC.
12 Article 458 of the SCC.
13 Article 462(2) of the SCC.
14 Article 471(1) of the SCC.
15 Article 471(2–3) of the SCC.
16 Article 470 of the SCC. In the presence of a surviving spouse or registered partner and of descendants, the compulsory share of the surviving spouse or registered partner will amount to 25 per cent of the estate (50 per cent of 50 per cent) and the compulsory share of the descendants will globally amount to 37.5 per cent of the estate (50 per cent of 75 per cent); the freely disposable share will in such cases amount to 37.5 per cent of the estate.
17 Article 522 et seq. of the SCC.
18 Article 533 of the SCC.
19 Article 483 of the SCC.
20 Article 484 of the SCC.
21 Article 517 of the SCC.
22 Article 493 of the SCC.
23 Article 482 of the SCC.
25 Article 498 et seq. of the SCC.

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agreements (to be executed before a notary public). By such an agreement, it is possible for a testator to obtain, for example, the consent of a protected heir to a waiver of his or her full compulsory share (either gratuitously or in exchange for some compensation).

Swiss inheritance law has been largely unchanged since the entry into force, in 1912, of the Swiss Civil Code (SCC); however, with the entry into force, in 2007, of the Federal Act on Registered Partnership, the registered partner has been granted the same rights in inheritance law matters as the surviving spouse. Further, Article 492a of the SCC, introduced in 2013, allows a testator to determine the destination of any assets remaining out of the share of a durably incapacitated heir of the testator without risk of infringing the incapacitated heir’s compulsory share.

Finally, the Swiss government is modernising existing inheritance law in a comprehensive way. At the heart of this reform are forced heirship rights, with the primary objective of limiting their scope and increasing the testator’s freedom. The reform should essentially reduce the compulsory share of the descendants (entitled to a compulsory share of 50 per cent of their intestate entitlement under the draft reform), of the surviving spouse or registered partner (protected up to 25 per cent of their intestate share according to the draft reform) and of the parents (their compulsory share is abolished under the draft reform). The reform also aims at easing the transfer of businesses, and promoting donations to charitable institutions. The draft reform bill also provides protection to unmarried couples by allowing forced maintenance claims by domestic partners, provided they have lived at least three years in a relationship with the deceased and made a significant contribution. The surviving partner must further need the maintenance award in order to ensure his or her existence and the amount awarded must be reasonable to expect from the heirs in view of their financial situation. This maintenance award is also granted to people who have lived as a minor for at least five years in a household with the deceased, if the deceased provided financial support to him or her and would have continued to do so if he or she were still alive.

In light of the consultation process, in which the Cantons, universities, associations or any person interested were given the opportunity to set out their views on the proposed changes, the Swiss government decided to proceed with the reform, although splitting it into two parts. The first part will address, among others, the key points outlined above; the second part will address other technical points. For both parts, a separate draft will be prepared. The publication of the draft regarding the first part of the reform is expected in 2018. Upon publication, the parliament will deal with this part of the reform, most likely in February or March 2019. The entire reform could enter into force the following year.

Even though not directly classed as inheritance law, it is important to mention that a revision of the rules on adult protection entered into force in 2013.

26 Articles 462 and 471 of the SCC.
27 The revision introduced new planning tools in relation to incapacitated persons. In particular, Articles 360 to 369 of the SCC now provide for the ‘advance care directive’ (mandat pour cause d’inaptitude), enabling a person with capacity to instruct a natural person or legal entity to take responsibility for his or her personal care or the management of his or her assets, or to act as his or her legal agent in the event that he or she is no longer capable of judgement. Articles 370 to 373 of the SCC foresee the possibility for a person with capacity to specify in a patient decree which medical procedures he or she agrees or does not agree to in the event that he or she is no longer capable of judgement.

409

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The Swiss conflict of laws rules seek to ensure, as far as possible, the principle of unity of succession. With this objective in mind, the foremost connecting factor in inheritance matters is the place where the deceased had his or her final domicile. 28

The Swiss courts generally have jurisdiction and apply Swiss law to the whole estate of a person whose final domicile was in Switzerland. 29 Some exceptions exist, in particular, in relation to real estate located in countries claiming to have exclusive jurisdiction over immovable assets; 30 the devolution of the estate of Swiss nationals domiciled outside Switzerland who make the appropriate election; 31 or assets located in Switzerland, where no foreign authority deals with them. 32 Further, Swiss conflict of laws rules enable foreigners (who do not have Swiss nationality at the date of death) with final domicile in Switzerland to submit the devolution of their estate to their national law. 33 This avoids the application of Swiss law, notably possible limitations on the creation of testamentary trusts and forced heirship rights.

As regards persons with their final domicile outside Switzerland, Swiss law 34 looks to the law designated by the rules of conflicts of the deceased’s final domicile. 35 In the overall context of conflict of laws rules, one should note that the new European Succession Regulation, 36 which governs and harmonises all conflict of laws aspects of cross-border successions in the Member States of the EU as from 17 August 2015, 37 has a significant impact on estate planning and settlement processes for Swiss resident individuals or Swiss nationals who have their last habitual residence in the EU, have left assets in the EU, or have elected the law of a Member State of the EU to govern their succession. The Regulation essentially establishes the principles that one single court has jurisdiction to rule on the succession as a whole and that the law of the state where the deceased had his or her last habitual residence also governs the whole of his or her succession. It contains further significant innovations, such as the possibility to elect the law of the state of which a person is a national to govern the succession (profession iuris) and a provision favouring the recognition of inheritance agreements. Switzerland is obviously not bound by the Regulation. Yet, considering its close relations with the EU, one may reasonably expect that these new rules should impact cross-border succession planning involving EU Member States bound by the Regulation. In this respect, we note that the Swiss government has proposed a reform of the conflict of law rules relating to succession to bring it more in line with those of the new European Succession Regulation. The reform provides, for example, that persons having more than one nationality may submit their estate to the law of one of their national states, even if such person has the Swiss nationality.

28 Within the Swiss meaning (see Article 20 of the Swiss Private International Law Act (SPILA) for a definition of domicile: ‘the place where a person resides with the intention of settling’), which is closer to the English notion of permanent residence than to the English notion of domicile.
29 Articles 86(1) and 90(1) of SPILA.
30 Article 86(2) of SPILA.
31 Article 87(2) of SPILA.
32 Articles 87(1) and 88 of SPILA.
33 Article 90(2) of SPILA.
34 Article 91(1) of SPILA.
35 Swiss law admits renvoi both in the form of remission and of transmission.
37 With the notable exception of the United Kingdom, Ireland and Denmark.
In the event that the deceased was married or bound by a registered partnership, the patrimonial relations between the spouses or registered partners first have to be liquidated to establish what is part of the deceased’s estate.

In this regard, even if marriage or registered partnerships generally have very limited effects on the powers of each spouse or registered partner to dispose of his or her assets during the marriage, some rules governing liquidation will need to be taken into account at the end of the marriage or registered partnership.

If the spouses have not entered into any matrimonial agreement, the ordinary Swiss property regime of participation in acquired property (ordinary regime) applies. In this case, each spouse will be entitled to a monetary claim against the other, amounting to half the net value of the assets acquired for consideration during the marriage (in particular, earnings from work and business assets, but not including assets owned prior to marriage or received through gift or inheritance thereafter).

By matrimonial agreement, spouses can adopt one of two other property regimes (the segregation of assets regime and the community property regime), or modify (to a limited extent) the ordinary regime. Rules are very similar as regards registered partners, except that the default regime is the segregation of assets regime.

In the event that the ordinary regime applies (which is the case for the vast majority of married couples in Switzerland), spouses remain to a very large extent free to deal with their assets as they wish. This being said, to avoid a situation where one spouse could deprive the other of his or her expectancies to half the net value of the assets acquired for consideration during the marriage, Swiss law contains protective provisions allowing – provided certain conditions are met – the taking into account of assets given away by a spouse without consideration in the calculation of the other spouse’s entitlements at the time the regime is liquidated. If the assets at that time are not sufficient to cover the spouse’s claim, it might even be possible in certain cases for the aggrieved spouse to claim assets from the person having received or benefited from the assets. According to a Geneva Court of Appeal decision, assets transferred to a trust set up by one of the spouses may be taken into account at their market value at the time of the transfer. A Federal Tribunal decision confirmed that in certain circumstances the aggrieved spouse may obtain a freezing of the trust assets.

In international situations, it should be noted that Swiss matrimonial law will apply to the patrimonial relationships between spouses and registered partners who are domiciled in Switzerland, unless they have chosen another applicable law (among their national laws) or are bound by a matrimonial contract. At the level of the EU, the Council adopted in 2016 two regulations implementing enhanced cooperation in the area of jurisdiction, applicable law and the recognition and enforcement of decisions on the property regimes.

38 Articles 181 and 196 et seq. of the SCC.
39 Article 18 et seq. of the Federal Act on Registered Partnership.
40 Article 201(1) of the SCC.
41 Articles 208 and 214 of the SCC.
42 Article 220 of the SCC.
43 Articles 52 to 55 of SPILA. This results in a change of the law applicable to the patrimonial relationships at the time the spouses or registered partners move to Switzerland, and this with retroactive effect to the beginning of the marriage (Article 55(1) of SPILA). In the absence of an agreement to the contrary, this means that the ordinary regime applies to newly arrived married couples (and the segregation of assets regime to registered partners).
The Regulations cover on the one hand matrimonial property regimes and on the other hand property consequences of registered partnerships. The Regulations will apply as from 29 January 2019 with regard to the participating EU Member States.

IV  WEALTH STRUCTURING AND REGULATION

In Switzerland, one must always distinguish between domestic and international situations.

In purely domestic planning, the use of vehicles is less common except for the very wealthy and for foreign investments. For example, when investing in foreign real estate, local advice may guide the investor towards a company, trust or foundation.

For the many foreigners who hold assets in Swiss banks, it is common that they might select either a trust or foundation, perhaps associated with a company that holds the banking relationship. This is – by some margin – the most significant market segment for the private wealth management sector in Switzerland.

One of the key features of present-day Switzerland is that, except for charitable structures, the trust or foundation that is used will not be Swiss. In this context, Switzerland has ratified and introduced the Hague Trusts Convention into law, thereby providing the basis for recognising trusts (as defined in the Convention) in Switzerland.

At the initiative of the Swiss parliament, the Swiss Federal Council is currently preparing a bill to include ‘the legal institution of the trust in Swiss legislation’. The Federal Council has appointed an expert committee to advise it in this respect. This has created a hospitable environment for trustees who wish to act as a trustee in or from Switzerland. Foreign foundations will be recognised and may be used but, as with companies, care must be taken to manage the potential tax consequences.

Both the private foundation or the trust will help the client administer his or her personal wealth and business assets efficiently and effectively during his or her lifetime and through to the next generations. In practice, the private foundation and the trust are not so different in their effects. They do, however, differ significantly in their structure and management. Unlike a trust, a foundation is an incorporated body that will come into existence upon the deposit or registration of its constitutional documents.

The key advantages of both vehicles are clear. A foundation is a vehicle created to exercise ownership and management rights. The appeal of the foundation is that, in the same way as a company, it possesses separate legal personality and operates like a company, but it does not have any shares. The foundation can also fulfil the same purposes as a trust with respect to asset protection and estate planning.

A discretionary trust’s main features are its capacity to protect assets and its capacity to provide a flexible arrangement for the distribution of income and capital among a wide range of beneficiaries. The great merit of the discretionary trust is its flexibility and, therefore, capacity to adapt to changing family circumstances, taxes and regulation.

The most appropriate structure will be dictated by several factors including how comfortable the client feels with either one.

i Taxation

Trusts

Swiss tax laws do not have specific rules regarding trusts, but the cantonal and federal tax authorities have issued administrative regulations regarding the taxation of trusts. Under these rules there is no taxation of a trust as such, or of the trustee in connection with the trust’s assets. Therefore, taxes, if any, are levied at the level of the settlor of a trust or at the level of the beneficiaries. For purposes of taxation, the authorities differentiate between revocable trusts, irrevocable discretionary trusts and irrevocable fixed interest trusts. Trusts may easily be considered revocable under the rules in place. Revocable trusts are disregarded for Swiss tax purposes. Irrevocable discretionary trusts are recognised unless they have been settled by a settlor who was a Swiss tax resident at the time of the establishment of the trust and they are hence often used as a component of pre-entry tax planning.

Foundations

As foundations have legal personality, foundations are themselves subject to profit tax and capital tax to the extent they are domiciled in Switzerland for tax purposes. Although foundations may be subject to a separate regime of taxation, as a holding company or a mixed company if the relevant conditions are fulfilled, tax rules applicable to foundations established in Switzerland are a clear obstacle to the use of Swiss foundations in an asset-structuring context. However, foundations whose assets are applied for charitable purposes are exempt from taxes and are hence often used in Switzerland.

ii Applicable anti-money laundering regime

The Swiss Anti-Money Laundering Act (AMLA) applies to all financial intermediaries who, on a professional basis, accept assets belonging to third parties.

Trustees and directors of foundations or offshore companies who conduct their business in Switzerland, regardless of the law governing the trust or foundation or the location of the assets, are Swiss financial intermediaries and subject to the provisions of the AMLA. Whether the protector of a trust falls within the definition of financial intermediary depends on his or her powers. The AMLA was amended on 1 January 2016 to introduce, in particular, serious tax offences as offences giving rise to money laundering.

The Swiss Association of Trust Companies (SATC) was established in 2007. Its purpose is to engage in the development of trustee activities in Switzerland and to help ensure a high level of quality, integrity and adherence to professional and ethical standards in trust businesses in Switzerland. The SATC imposes certain requirements on its members.

The Swiss financial regulatory framework is undergoing further important structural changes. Historically, only banks, insurance companies, financial intermediaries active in the field of collective investment schemes (e.g., fund management companies), securities dealers and stock exchanges have been subject to a licensing obligation in Switzerland. Asset...
managers, except in limited cases when acting as the manager of a Swiss fund, were not required to be licensed unless the asset managers had custody of client assets. In the fund sector, Swiss managers of non-Swiss funds are now subject to a licensing requirement. This legal reform was embodied in a revision of the Federal Act on collective investment schemes, driven by the EU’s Alternative Investment Fund Managers Directive. Such revision entered into force on 1 March 2013. Further, Swiss and foreign asset managers of Swiss pension funds must be duly supervised.

In addition, on 15 June 2018, the Swiss parliament adopted the Federal Act on Financial Services as well as the Federal Act on Financial Institutions. This new legislation is subject to a potential referendum, which is, however, very unlikely.

The objective of the Federal Act on Financial Services is to provide for a new legal framework on the provision of financial services in Switzerland, including when such services are provided on a cross-border basis into Switzerland. The main features of the Federal Act on Financial Services are the rules of conduct (e.g., suitability or appropriateness tests), which are largely inspired by EU standards, in particular the Markets in Financial Instruments Directive. The Act provides for a new registration requirement applicable to non-Swiss financial services providers who render services in Switzerland on a cross-border basis.

The objective of the Federal Act on Financial Institutions is to provide for a new legal framework governing the supervision of all financial institutions, with the exception of banks and insurance companies that remain regulated by specific legislation tailored to their needs. A key alignment with international standards is the introduction of a prudential supervision over independent asset managers and trustees. This prudential supervision is based on a 'two-tier supervisory regime', where the Swiss Financial Market Supervisory Authority (FINMA) is responsible for licensing the independent asset managers and trustees, with a right to impose sanctions and set minimum requirements, including as to corporate governance, but where the ongoing (day-to-day) supervision is delegated to privately organised and FINMA-licensed supervisory organisations. This system benefits from a wide consent within the Swiss financial industry and is a positive element of the new legislation.

It is expected that both the Federal Act on Financial Services and the Federal Act on Financial Institutions will enter into force at the earliest in January 2020. In the meantime, the Swiss Federal Finance Department is in the process of finalising the draft implementing ordinances of both Acts and will proceed with the formal consultation process, which is expected to take place from October 2018 to February 2019. Other than further specifying many key provisions of this new legislation, these ordinances will define the transitional provisions as to the implementation of the new rules. These ordinances will be finalised only shortly before the entry into force of the Federal Act on Financial Services and the Federal Act on Financial Institutions.

Further and independently from the Federal Act on Financial Services and Federal Act on Financial Institutions, the Banking Ordinance was modified. The reliefs that were incorporated aim to accelerate the development of fintechs within the Swiss financial market.

V OUTLOOK AND CONCLUSIONS

As can be seen from the above, Switzerland is undergoing rapid and profound change.

In 2009, Switzerland adopted the OECD international standard for the exchange of information under tax treaties, a move heralded as the end of banking secrecy and tax avoidance for people holding undeclared funds in Swiss banks.
In late 2012, the government announced the details of its white money strategy and identified the areas of asset management, pension funds and capital markets as those with significant growth potential. To help in this regard, the government plans to base its financial market policy on strengthening competitiveness, combating abuses and improving the framework, with quality, stability and integrity as its key objectives.

Since then, the US programme and related settlements, FATCA implementation, automatic exchange of information involving the EU and the rest of the world, amendments to AMLA and the major revision of the law on financial services and institutions as well as a clear fintech strategy, give hope that Switzerland has bedded down its framework for the era of transparency.

In the short to medium term, the uncertainty that accompanies change and the complexity and cost that goes hand-in-hand with such profound changes is affecting the whole wealth-management industry. The government’s ambition to close Switzerland to undeclared funds and develop a strong financial services sector is clear.

At different times, the features that make Switzerland attractive have had varying importance. It should be clear to all concerned that Switzerland will be less secretive in the future. It is certainly not a tax-neutral jurisdiction, but there are still many reasons why it remains the home of individuals of significant wealth and a key player in the custody and management of private wealth. In the current environment, it appears that Switzerland’s status as a safe haven has retaken centre stage.
UNITED KINGDOM

Christopher Groves

I INTRODUCTION

The United Kingdom of Great Britain and Northern Ireland constantly strives to maintain a state of harmony between contradictory policy objectives. The United Kingdom maintains a level of government spending of between 40 per cent and 50 per cent of GDP by being a high-tax jurisdiction for its own nationals. This is illustrated by a top rate of income tax of 45 per cent, among the highest in the Organisation for Economic Co-operation and Development countries, and capital gains tax at 20 per cent (other than for residential property).

However, for non-UK-domiciled persons it maintains a status as a relative tax haven, taxing only income and gains arising in or remitted to the United Kingdom, potentially allowing non-working individuals to become resident in the United Kingdom without any direct tax liability at all. In this way, the UK tax system works to attract non-UK persons, in particular those with capital resources or unearned income, while at the same time imposing significantly greater tax burdens on UK nationals. Cecil Rhodes counselled Englishmen to remember that they had won the lottery of life, but clearly did not have the 21st century's income tax rules in mind.

Historically, the United Kingdom has always had a significant role as a mercantile centre, reflected in the position of the City of London as a major global financial centre, and the cosmopolitan and multicultural make-up of the individuals who live and work there. Building on its commercial strengths, the United Kingdom has sought to maintain a benign tax regime for business, to encourage investment and fund managers, lawyers, accountants and other wealth advisers to establish business in the United Kingdom, with the country being repaid in the tax on the profits of those businesses, rather than tax on the funds or persons advised. It has not sought to attract funds under management into the jurisdiction, but instead to position itself as a centre for the management of such assets. Indeed, with so many of its remaining dependencies and overseas territories being dependent on the revenues they generate from their role as offshore financial centres, the United Kingdom could be seen to have a vested interest in maintaining this distinction.

The outcome of this is that the United Kingdom exists as a relative tax haven and as a home jurisdiction of choice for many wealthy individuals, while at the same time applying some of the highest levels of marginal taxation on its own citizens. It does not seek to attract investment assets but actively courts the managers and advisers of those assets. However,

1 Christopher Groves is a partner at Withers LLP.
recent changes and proposals for future changes have started to erode this status and the UK is becoming less favourable to longer-term residents. It remains to be seen whether it will maintain this position.

The current watchword of UK tax policy is ‘fairness’. This does not seem to be applied, however – to paraphrase Marx – in each contributing to the exchequer in accordance with his or her ability to pay, or even progressively, but rather the policy is that every resident or taxpayer should be seen to make a contribution and, where unfairness is perceived, steps should be taken to correct it.

II TAX

It has been this desire to achieve a perceived fairness that has characterised the development of the UK tax system in recent years. Efforts have largely been concentrated on ensuring the fair and efficient operation of the existing tax system, closing loopholes, seeking to maximise the collection of existing liabilities and countering the abuses of avoidance and evasion.

i Personal taxation for individuals

Individual taxation

Individual taxation in the United Kingdom is administered on a self-assessment basis. On this basis each taxpayer is required to give Her Majesty’s Revenue and Customs (HMRC) sufficient information for HMRC to be able to determine that individual’s liability to tax in any tax year, which by quirk of history runs from 6 April to 5 April in the next year.

Income and capital gains are assessed and taxed separately. Income tax is charged progressively, with individuals earning more than £150,000 per year paying a marginal rate of tax of 45 per cent. Interest income benefits from a £5,000 exemption and dividend income is charged at lower rates.

Capital gains tax also currently has a progressive element, with higher earners paying a higher rate of tax. In recent years, the United Kingdom has moved from a headline capital gains tax rate of 40 per cent (aligned with income tax rates) that reduced to a minimum of 24 per cent (or 10 per cent for certain assets) depending on the length of time that the asset had been owned (known as taper relief) to, in 2008, a lower flat rate (initially 18 per cent, increased to 28 per cent in 2010 and then reduced to 20 per cent in 2016 for higher rate taxpayers) and with no reduction for long-term capital gains.

For savings, a ‘starting rate’ applies to the first £5,000 of such income as well as a tax-free dividend allowance of £2,000

A summary table for the tax year 2018–19 follows:

<table>
<thead>
<tr>
<th>Income tax</th>
<th>Other income</th>
<th>Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal allowance</td>
<td>£11,500</td>
<td>Tax-free</td>
</tr>
<tr>
<td>Basic rate</td>
<td>£11,501 to £45,000</td>
<td>20%</td>
</tr>
<tr>
<td>Higher rate</td>
<td>£45,001 to £150,000</td>
<td>40%</td>
</tr>
<tr>
<td>Additional rate</td>
<td>Above £150,000</td>
<td>45%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital gains tax</th>
<th>Other assets</th>
<th>Residential property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual allowance</td>
<td>£11,000</td>
<td>Tax-free</td>
</tr>
<tr>
<td>Basic rate</td>
<td>Up to £31,865</td>
<td>10%</td>
</tr>
<tr>
<td>Higher rate</td>
<td>Above £31,866</td>
<td>20%</td>
</tr>
</tbody>
</table>
Since 6 April 2018, the Scottish government has exercised its powers to vary the rate of tax for Scottish residents, introducing a ‘starter’ rate at 19 per cent and ‘intermediate’ rate at 21 per cent of tax between the basic and higher rates that apply to the rest of the UK.

For the purposes of assessing the thresholds, total income is calculated and assessed first, with the thresholds for capital gains tax being calculated in addition to income.

The remittance basis
As discussed above, the defining characteristic of the United Kingdom’s personal tax regime for high net worth individuals moving to the United Kingdom is the remittance basis of taxation. The remittance basis essentially provides that, for those who claim it in any particular tax year, only income and capital gains arising in or remitted to the United Kingdom are subject to taxation. The remittance basis (or versions thereof) has existed within the United Kingdom’s income tax system since it was first introduced in 1799, originally perhaps largely as a result of the administrative problems of assessing foreign income. Only from 1914 was the remittance basis restricted to persons not domiciled in the United Kingdom.

Domicile is a concept of UK law that seeks to identify an individual’s ‘home’. Every person acquires a domicile of origin at their birth, usually the domicile of their father when they were born. A domicile of origin can be replaced by a domicile of choice in another jurisdiction if the individual moves to that jurisdiction and decides to remain there permanently or indefinitely. In determining whether a domicile of choice has been acquired, the individual’s intention is key, and it is possible to remain resident in a jurisdiction for many years without becoming domiciled there.

The continued existence of the remittance basis remained a point of controversy and when a Labour government came to power in 1997, it committed itself to a review of the remittance basis. This review did not produce any significant change until 2008 when the remittance basis charge was introduced. The remittance basis charge is applied to non-domiciled individuals who have been resident in the United Kingdom for seven out of the previous nine tax years. From that point on, in any year in which they wish to claim the remittance basis, they must pay an annual charge of £30,000. From the tax year 2012–13, this was increased to £50,000 for individuals resident in the United Kingdom in 12 of the previous 14 tax years.

Recent developments
Since 2010, a number of changes have been introduced to seek to make the United Kingdom’s tax system simpler and fairer. In 2015, it was announced that non-domiciled individuals resident in the UK for more than 15 years would no longer be able to claim the remittance basis. These rules were due to be implemented from April 2017.

The rules will provide that once a non-domiciled individual has been resident in the UK in 15 of the previous 20 years, he or she will no longer be able to claim the remittance basis and will be subject to income and capital gains tax on a worldwide basis. As a concession to these ‘long-term non-doms’ the legislation will also provide for an exemption for this charge for income and gains (other than UK-source income) on assets held in trust after 15 years of residence, providing no further sums are added to such trusts, after 15 years of residency.

Residency rules
The previous rules on when an individual was considered to be resident in the United Kingdom were defined partly by statute, but largely by the common law. They could be
summarised as follows: an individual who was physically present in the United Kingdom in any tax year for a permanent purpose was to be considered resident, whereas an individual who was physically present in the United Kingdom only for a temporary purpose was not. Determining what was a temporary or permanent purpose and for those who wished to give up UK residency when a permanent purpose ceased proved a matter of some contention, in which every factor of an individual’s life had to be considered.

In response to this, a new statutory test was introduced on 6 April 2013, which seeks to provide a strict day-count test to determine whether an individual is resident in the United Kingdom. The number of days that will determine whether an individual is resident will depend on five potential ties to the United Kingdom:

a. whether the individual has a partner or minor children in the United Kingdom in the tax year;
b. whether the individual has a home available to them in the United Kingdom in the tax year;
c. whether the individual works in the United Kingdom for more than 40 days in the tax year;
d. whether the individual has spent more than 90 days in the United Kingdom in either of the previous two tax years; and
e. whether the individual has spent more days in any other single jurisdiction than in the United Kingdom in the tax year.

The number of days that an individual can spend in the United Kingdom without being treated as resident will depend on whether they have previously been resident in the United Kingdom and how many ties they have to the United Kingdom in any tax year. Any individual spending less than 15 days in the United Kingdom in any tax year will not be considered resident for that year and any individual present for more than 183 days is conclusively resident.

To decide whether an individual is a ‘leaver’ or ‘arriver’ under the new rules, HMRC has confirmed that the individual may elect to use the old pre-6 April 2013 rules or the new statutory residence test on the basis that the statutory residence test was deemed to be in place for the tax years 2012–13, 2011–12 and 2010–11.

**Tax avoidance**

It had been thought that an established principle of English law was: ‘Every man is entitled, if he can, to order his affairs so that the tax . . . is less than it otherwise would be.’ However, in recent years the morality if not the legality of tax avoidance has been questioned by both politicians and the press, culminating in the then Chancellor of the Exchequer announcing in March 2012 that he regarded aggressive tax avoidance as ‘morally repugnant’ and would take steps to counteract what might otherwise be regarded as legal tax planning.

For a number of years, the courts have been invoking a doctrine, known as the ‘Ramsay principle’ after a leading case, that allowed transactions to be recharacterised to deny a particular tax result when it was felt that was not the purpose of the legislation that it should deliver that result.

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However, this approach by the courts was generally felt to be uncertain and unsatisfactory for taxpayers and government. As a result, the government introduced a general anti-abuse rule (GAAR), which applies to tax arrangements entered into on or from 17 July 2013. The purpose of this GAAR is to target ‘artificial and abusive arrangements’ and counteract them to deny any tax advantage sought. It will apply to, *inter alia*, income tax, national insurance contributions, capital gains tax, inheritance tax and the annual tax on enveloped dwellings (ATED).

It is the intention that the GAAR should introduce greater certainty and fairness into the UK tax system, giving taxpayers and tax collectors alike greater clarity as to what is permitted and what is not. Considerable doubt remains as to whether it will achieve this, however. It is notable that there is no clearance procedure for GAAR and a lack of complete independence between the GAAR advisory panel and HMRC. It is still too early to say how exactly the GAAR will apply and indeed how HMRC may choose to apply it. But suffice to say at this stage there is a degree of additional caution surrounding UK tax planning.

At a more general level, the distinction between (illegal) tax evasion and (legitimate) avoidance is becoming increasingly blurred in the political arena. A clear manifestation of this is the moral outrage exhibited when the Panama Papers revealed in April 2016 that the then Prime Minister's father had managed a (UK tax-compliant) non-UK resident investment fund. There is increasing social pressure on companies and individuals to conduct their affairs, not just within the letter of the law, but also in a spirit of not reducing their liability to taxation.

**Taxation of residential property**

The rate of transfer tax (stamp duty land tax (SDLT)) that applies to residential property has been progressively raised over recent years to increase the level of tax paid by owners of high-value residential property. As of 1 April 2016, a surcharge of 3 per cent applies to the rate of SDLT on the purchase of ‘second homes’. This surcharge, which will apply to almost any non-resident purchasing a residential property in the UK, raises the top rate of SDLT paid by individuals to 15 per cent.

The current rates of tax, which apply on increasing portions of the property price above £125,000, are set out in the table below:

<table>
<thead>
<tr>
<th>Purchase price of property</th>
<th>Rate of SDLT</th>
<th>Rate of SDLT on second homes</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0–£125,000</td>
<td>0%</td>
<td>3%</td>
</tr>
<tr>
<td>£125,001–£250,000</td>
<td>2%</td>
<td>5%</td>
</tr>
<tr>
<td>£250,001–£925,000</td>
<td>5%</td>
<td>8%</td>
</tr>
<tr>
<td>£925,001–£1.5 million</td>
<td>10%</td>
<td>13%</td>
</tr>
<tr>
<td>Above £1.5 million</td>
<td>12%</td>
<td>15%</td>
</tr>
</tbody>
</table>

There have been a number of targeted measures designed to counter particular perceptions of tax avoidance, notably with regard to the ownership of high-value residential property. To counter a concern that structures whereby residential properties owned by non-UK companies were facilitating the transfer of ownership in those properties without the payment of SDLT, in March 2012, a number of new rules applying to residential properties worth more than £2 million were announced:

* The rate of SDLT paid by certain non-natural persons purchasing UK residential properties for more than £2 million was raised from 5 per cent to 15 per cent, and the
rate for all other purchasers was raised to 7 per cent. The Finance Act 2013 introduced a number of important reliefs that effectively restricted the 15 per cent rate of SDLT to private residential property. The 15 per cent rate was extended by the Finance Act 2014 to properties over £500,000, with effect from 20 March 2014.

b From 1 April 2013, an annual charge known as the ATED was levied on up to 0.75 per cent of the gross value on certain non-natural persons who own UK residential properties worth more than £2 million. The Finance Act 2013 again introduced reliefs that limited the effect of the ATED to broadly those structures holding private residential property. The Finance Act 2014 introduced two new ATED bandings: an annual charge of £7,250 applying to properties worth over £1 million up to £2 million from 1 April 2015 and, from 1 April 2016, an annual charge of £3,600 for properties valued at between £500,000 and £1 million.

c Certain non-resident non-natural persons selling interests in UK properties, subject to the ATED, for more than £2 million will be subject to capital gains tax in the United Kingdom on post-6 April 2013 gains. The value subject to the charge to tax will be extended to disposals of properties worth over £1 million to £2 million from 6 April 2015 and between £500,000 and £1 million from 6 April 2016.

d From April 2016, individuals (or married couples) purchasing a second residential property are subject to a 3 per cent surcharge above the standard rates of SDLT, with limited exceptions for *de minimis* property interests and the replacement of an existing main residence.

These rules are effectively limited to ‘owner-occupied’ residential properties, with ‘genuine businesses’ that own residential property largely being exempt, and while highly targeted, these rules represent two dramatic shifts in UK tax policy. For the first time, the United Kingdom has an annual tax based on the value of assets owned – a wealth tax in all but name. Wealth taxes have been proposed in the United Kingdom previously but never enacted, and while there was considerable discussion in advance of the 2010 general election, the idea seemed to have been discarded. The question will be whether, once introduced, the wealth tax will be extended to cover other assets and taxpayers.

The stated objective of these changes is to encourage property owners to own UK property directly, rather than through non-UK structures, primarily to ensure that the SDLT is not avoided on sale. However, this will also have the consequence of bringing those persons within the scope of UK inheritance tax on death, which can give rise to much more significant tax charges.

Further, UK capital gains tax has previously only been assessed on persons resident in the United Kingdom. The extension of capital gains tax to non-residents again represents a significant departure from the previous norms of UK tax policy. Up to 2012, the United Kingdom had been highly unusual in that it did not seek to tax non-residents on profits derived from the alienation of real (or indeed any other form of) property in the United Kingdom. As of 6 April 2015, all non-resident owners of UK residential property are subject to capital gains tax on the sale of such properties at 28 per cent.

**Inheritance tax and property**

From July 2013, new conditions were placed on the deductibility of loans for inheritance tax planning purposes. It was previously standard planning practice to reduce the liability to UK inheritance tax (IHT) by using loans to finance the acquisition of assets that benefit
from advantageous reliefs (business property relief, agricultural property relief and woodlands relief) and excluded status from IHT. The new conditions and restrictions significantly restrict the ability to claim a liability as a deduction for inheritance tax purposes, unless the liability was (originally) used for the original purchase of a residential property.

The impact of these rules are also more widespread following further changes announced in 2015, which should have come into effect in April 2017. As with the new rules for long-term non-doms, the legislation for these rules is yet to be enacted, although again, it should be presumed that this will occur at some point in 2018. Up to this point, UK residential property owned directly by non-UK domiciliaries or non-UK residents has always been subject to IHT, but shares in a non-UK company that in turn owns UK property have not. In this way, many owners of houses in the UK have fallen outside the scope of IHT.

With effect from April 2017, it is proposed that the IHT rules will be amended so that the value of any interest in a company or other entity that indirectly owns residential real estate in the UK, or did at any time in the preceding two years, is brought within the scope of IHT for non-UK resident individual shareholders or shareholding trusts, on death, where gifts are made in the seven years preceding death, or on the 10-year anniversaries of a trust (as set out below).

These rules will only apply to residential property, or ‘dwellings’; however, there is still some confusion as to what constitutes a dwelling. There is no exemption for principal residences (such as applies to non-resident capital gains tax) or any de minimis values or reliefs for property rental businesses (such as apply to ATED).

These rules will also apply to certain loans advanced (or guarantees given) to individuals or trusts to purchase residential property, so that the lender will be treated as holding an asset within the charge to inheritance tax.

ii Gift and succession taxes

Since 1984, the United Kingdom has applied an estate tax rather than an inheritance tax, but it is called inheritance tax. As an estate tax, IHT is applied to the deceased’s estate on death and (usually) must be paid before the deceased’s property can be distributed among his or her heirs. A single rate of 40 per cent is applied across a UK-domiciled deceased’s worldwide estate, above a tax-free ‘nil rate band’ currently of £325,000.

Unlike jurisdictions that apply a genuine IHT, in the United Kingdom differential rates do not apply to legacies to different persons (e.g., reduced rates for gifts to family members) other than to spouses, who are exempted from the IHT, providing they are UK-domiciled or share the domicile of their spouse. There are further exemptions, including for gifts of property to charity or political parties and reliefs (up to 100 per cent of the tax payable) for closely held businesses and agricultural property.

There is no gift tax in the United Kingdom. However, IHT will apply to some transfers made during a lifetime. Any gift made in the seven years prior to death will be included in the value of the deceased’s estate for the purposes of assessing the total IHT liability, although the rate of tax is reduced on gifts made at least three years before death. Since 2006, most transfers into trusts are immediately subject to IHT at the lifetime rate of 20 per cent, with additional tax to pay, up to the 40 per cent rate, if the donor dies within seven years of the transfer. The same exemptions for gifts to spouses and charities and reliefs for closely held businesses and agricultural property will be available, as on death.

As is the case in respect of personal taxation, non-UK-domiciled persons (whether resident or non-resident) enjoy a privileged position in that they are only subject to IHT on
their UK *situs* assets, subject to the exception for indirectly held UK residential property set out above. However, unlike with direct taxation, there is a sunset provision, so that non-UK-domiciled persons who have been resident in the United Kingdom in 15 of the preceding 20 tax years are deemed domiciled in the United Kingdom for the purposes of IHT, in any event (again subject to the enactment of the necessary legislation).

This has caused some quirks in the administration of IHT. However, to address one long-standing anomaly a non-domiciled spouse may now elect to be domiciled for UK IHT purposes and the limited spouse exemption for transfers between domiciled and non-domiciled spouses has been extended from £55,000 to £325,000 and linked to the value of the nil rate band.

Since 2006, when the treatment of lifetime transfers into trust was changed so that most transfers became subject to an immediate charge to IHT, UK inheritance tax has recently remained largely unaltered. One consequence of the current fiscal austerity has been that the nil rate band of £325,000 that was previously increased each year in line with inflation has been frozen since 2009 and is planned to remain frozen until 2018.

### iii Cross-border structuring

The United Kingdom has been at the forefront of the international moves to recover unpaid tax liabilities in respect of funds held outside the home jurisdiction. In addition to a number of general and targeted amnesties in the United Kingdom, it has entered into high-profile agreements with Switzerland, Jersey, Guernsey, the Isle of Man and Liechtenstein to enable it to recover unpaid tax liabilities, in respect of funds held offshore.

**The UK–Swiss agreement**

The Swiss agreement provides that there will be a one-off withholding tax applied on funds held in Switzerland that have not been disclosed to HMRC in respect of all past tax liabilities.

From 2013, withholding taxes of 48 per cent on interest income, 40 per cent on dividend income and 27 per cent on capital gains will be applied to all accounts held by UK taxpayers unless the account holder discloses the account to HMRC.

**Disclosure facilities and the requirement to correct**

The Liechtenstein disclosure facility was the forerunner of the UK–Swiss agreement and provides an alternative mechanism whereby, for five years from 2009, UK taxpayers can regularise their affairs with HMRC.

The facility allows individuals with assets formed, administered or managed in Liechtenstein to disclose past tax irregularities without fear of criminal prosecution; however, unlike the UK–Swiss agreement, there is no provision for ongoing withholding taxes or a general withholding levied on all undeclared accounts. This effective amnesty, now closed, provided for the repatriation of significant undeclared funds.

The United Kingdom also entered into memorandums of understanding with Jersey, Guernsey and the Isle of Man, setting out further respective disclosure facilities providing UK taxpayers with assets in these jurisdictions the opportunity to bring their UK tax affairs up to date. The disclosure facilities ran from 6 April 2013 until 30 September 2016.

The only disclosure facility open to persons with unpaid UK tax liabilities is the ‘Worldwide Disclosure Facility, which opened on 5 September 2016 and which offers taxpayers with unpaid UK tax liabilities relating to non-UK matters a mechanism for making unprompted disclosures.
As of 30 September 2018, a new ‘requirement to correct’ will oblige all taxpayers with undeclared UK tax liabilities involving offshore matters to disclose these to HMRC or face an enhanced penalty regime, with penalties of up to 200 per cent of the unpaid tax being charged.

**Transparency**

The United Kingdom also remains at the forefront of moves to create a new global reporting standard, as well as registers of public ownership of companies and trusts. As of 1 April 2016, UK incorporated companies must prepare a publicly available register of ‘persons with significant control’ that can be used to identify beneficial shareholders of those companies. Plans have also been announced for a public register of owners of UK residential property owned by non-resident companies.

**iv Entrepreneurs and business owners**

It is a stated aim of the current UK government to encourage business and entrepreneurship through the tax system and a number of recent changes have been implemented to achieve this.

When the current government came to power in 2010, it created the Office of Tax Simplification to provide independent advice on reducing the complexities of the UK tax system and the consequential burdens on business. The office has reported this year on a number of issues, but whether it will have any significant effect on the complexity of legislation is not yet clear.

The main rate of corporation tax was reduced from 28 per cent in 2010 to 24 per cent in 2012, 23 per cent in 2013, and now, in 2018, to 21 per cent, with a long-term goal of reducing it to 17 per cent.

From the business owners’ point of view, the amount of capital gains that can qualify for entrepreneurs’ relief, under which the rate of capital gains tax on the sale of businesses or business assets is reduced to 10 per cent, has been kept at the £10 million level that was introduced in 2011; however, a new parallel ‘investors’ relief’ that also reduces the tax rate to 10 per cent on the sale of certain private company shares was introduced in 2015.

Dividends are also subject to more favourable tax rates in the United Kingdom than either interest or earned income, as set out in the table above.

**III SUCCESSION**

i **UK succession rules**

A fundamental principle of succession law in the United Kingdom is the freedom of testamentary disposition, so that individuals are generally free to dispose of their estates to whomever they wish and are not subject to forced heirship rules. Only in the absence of a will does the UK mandate how an individual’s estate should be divided.

However, for UK domiciliary residents there are some constraints on this freedom under the Inheritance (Provision for Family and Dependants) Act 1975. This Act provides that a surviving spouse or civil partner will have similar rights to provision from a deceased person’s estate as they would have on divorce. Other family members and dependants also have the right to be provided for from a decedent’s estate, although the level of provision is not prescribed.
Non-UK domiciliary residents are again treated differently from UK domiciliary residents. While the United Kingdom will apply UK law to the devolution of real property situated in the United Kingdom, it will apply the law of the deceased's domicile to the devolution of their personal property situated in the United Kingdom.

The United Kingdom has not adopted the EU Regulation on Succession and Wills.

ii Matrimonial issues

Division of assets on divorce

In England and Wales, the court has wide powers to make financial provision when a marriage or a civil partnership breaks down, which can include ongoing maintenance payments, provision for children and the adjustment or variation of interests in trusts and other property, as well as the payment of lump sums.

The court has a wide discretion to determine what would be a fair financial outcome for both parties, having regard to all of the circumstances of the case at that time. It will take into account all of the assets of both parties (whether liquid or illiquid and from whatever source and wherever located in the world) including trust interests, assets acquired prior to the marriage and or by way of inheritance, in determining the appropriate financial division and level of provision to be made.

There is no mathematical formula for working out the appropriate division of assets and income. The aim is to achieve a division that is fair, but the court has emphasised that a 50:50 division of assets is frequently the correct result unless there are compelling reasons to the contrary, such as one party having entered a short to moderately long marriage with significantly greater assets than the other. If the court departs from equality, it should give reasons for doing so.

In the joined cases of Miller and McFarlane, the House of Lords drew a distinction between matrimonial property (being property and assets acquired during the marriage through common endeavour) and other property and assets (such as that brought into the marriage or acquired by inheritance or gift during the marriage). Relevant factors used to distinguish these categories of the property would involve assessing its nature and value; the time when and circumstances in which it was acquired; and the way in which it was used during the marriage.

To the extent that the pre-acquired and inherited wealth is kept largely separate and not used as a resource for funding lifestyle during the marriage or civil partnership, it may be possible to protect it and for it to be retained intact in the event of future divorce or dissolution proceedings, subject to any needs-based claim of the other spouse or partner. This is less so if pre-acquired or inherited assets have been used as a family resource during the marriage or civil partnership.

In the exercise of its discretion, the court will always strive to meet the needs of both parties, even if that results in the division of value and potential realisation of pre-acquired or inherited assets.

**Prenuptial agreements**

For many years, prenuptial agreements were not treated as binding or even influential by English courts, but in recent years there have been moves to increase their importance. The leading authority on prenuptial agreements is now the case of *Radmacher v. Granatino*. The essential point of principle arising from the Supreme Court decision in that case is that the Court should give effect to a nuptial agreement that is entered into freely by each party with a full appreciation of its implications unless in the circumstances prevailing it would not be fair to hold the parties to their agreement.

The Supreme Court did not set out clear guidelines for judges or lawyers about when and in what circumstances prenuptial agreements would be regarded as fair or unfair. Instead, it said this would depend upon the facts of each particular case, and, if a prenuptial agreement is to be entered into, clear advice should be taken on the procedure.

The Law Commission (the body that advises the government about law reform) published a report in February 2014 considering the role of prenuptial agreements under English law. The report proposed, in particular, that nuptial agreements should be legally binding provided they adhere to procedural safeguards and formation requirements.

**Same-sex marriage**

The Civil Partnership Act 2004 introduced a new legal relationship, distinct from marriage, between same-sex couples. Civil partners have the same legal rights and responsibilities as married couples in many respects, but the institutions are not identical.

A change in the law, which came into effect on 5 December 2011, now enables civil partnerships to be registered on religious premises where religious organisations permit this, and the premises have been approved for the purpose. The new law also states, for the avoidance of doubt, that religious organisations will not be obliged to host civil partnership registrations if they do not wish to do so.

The Marriage (Same Sex) Couples Act 2013 came into force on 13 March 2014, enabling same-sex couples to marry and civil partners to convert their partnerships into marriages.

The government published a formal review on the future of civil partnerships on 26 June 2014, as required by the Act, announcing that it did not intend to make any changes to their operation.

**IV WEALTH STRUCTURING AND REGULATION**

i **Onshore wealth structuring**

Historically, the most commonly used vehicle for wealth structuring onshore in the United Kingdom was the trust, which provided a tax-efficient mechanism through which to separate legal ownership from the beneficial enjoyment of assets; however, following changes to the taxation of trusts in 2006, they have declined in popularity.

The 2006 changes meant that most transfers into trust above the amount of the nil rate band are taxed to IHT at the lifetime transfer rate of 20 per cent and further IHT charges, at a rate of up to 6 per cent, are imposed every 10 years. In addition to this, UK-resident trusts are now subject to income and capital gains tax at the highest individual rates: 45 per cent for income and 28 per cent for capital gains.

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4 [2010] UKSC 42.
This has led UK practitioners to look increasingly for alternative structures for wealth structuring. The objective of many structures is now to implement a control structure, while retaining the tax profile of direct ownership. This has led, for example, to the increased use of family limited partnership and family investment company structures.

For individuals seeking to achieve a more beneficial tax profile, the reduction in the rate of corporation tax has increased the attraction of the use of family holding companies. Where profits are accumulated, these can benefit from the lower rates of corporation tax and the exemption from corporation tax of dividends. In addition, by creating different classes of shares with different rights it is possible to achieve a variety of estate planning objectives.

ii  Offshore wealth structuring

The United Kingdom’s anti-avoidance rules have largely precluded UK domiciliary residents from structuring wealth offshore, but for non-UK domiciliary residents residing in the United Kingdom, offshore trusts can offer very significant advantages in terms of protecting assets from UK capital gains tax and inheritance tax.

Foundations, which are being adopted in other common law jurisdictions such as the Channel Islands, have no parallel in UK law and are treated for tax purposes either as trusts or companies, depending on the particular structure employed.

V  OUTLOOK AND CONCLUSIONS

The United Kingdom’s response to the credit crisis and subsequent recession has largely been to increase the burden of indirect taxation (by an increase in value added tax) and to reduce corporation tax rates in a bid to encourage enterprise. Although the higher rate of income tax at 50 per cent was introduced in 2010, this was reduced to 45 per cent in 2013 and the United Kingdom has not seen the more draconian proposals put forward by some of its neighbours.

At the macro level in particular it seems to have struck a better balance in its tax system. The introduction of the remittance basis charge allows non-domiciliary residents to demonstrate that they contribute to the UK exchequer and has largely defused the debate as to whether the regime should be abolished in its entirety. At the same time, the United Kingdom has sought to increase the perception of its tax system as one that is friendly and stable, not necessarily seeking to be a low-tax jurisdiction but a stable one in which individuals can base themselves for the long term, without undue concern as to the risk of legislative change. This, however, has not been borne out in practice, with successive governments introducing progressive changes, particularly to the taxation of high net worth individuals, that have made long-term planning challenging.

At a micro level, the continued emphasis on countering tax avoidance has made planning for individuals more complicated, as advisers have to take into account not only the relative certainties of the letter of the law, but also in considering the GAAR, the spirit and intent of that legislation in analysing appropriate planning techniques.

In the coming years, the key driver for UK policy will likely be the outcome of the negotiations regarding its exit from the European Union. Pending completion of those negotiations, there remains considerable uncertainty in the UK as to the future direction of tax policy. It seems likely, however, that once outside the European Union, the United Kingdom will seek to consolidate its position as a relatively low-tax jurisdiction among the
large developed economies, especially for corporates. While pressure may continue on tax revenues, it seems that any further legislative change will be in the form of targeted measures, such as the taxes on UK property, rather than a general increase in tax rates.
Chapter 38

UNITED STATES

Basil Zirinis, Katherine DeMamiel, Elizabeth Kubanik and Susan Song

I INTRODUCTION

In December 2017, President Donald Trump signed into law the Tax Cuts and Jobs Act (TCJA). Under the TCJA, individual and corporate income taxation has been significantly changed. For example, many deductions previously available to individual taxpayers have been temporarily eliminated or limited, and the top individual income tax rate was decreased from 39.6 per cent to 37 per cent. The estate tax remains in force despite proposals for its elimination, but the lifetime exemption from estate, gift and generation-skipping transfer tax was essentially doubled for US citizens and domiciliaries to US$11.18 million for 2018. The lifetime exemption for non-resident individuals, however, remains at US$60,000. These changes will have effect from 2018 until 2025.

With respect to entity taxation, significant changes include the reduction of the maximum corporate income tax rate from 35 per cent to 21 per cent, and substantial modifications to the rules regarding controlled foreign corporations (CFCs). Specifically, the TCJA modified the rules regarding who is considered a US shareholder and who is a substantial shareholder, and introduced the concept of global intangible low-taxed income (GILTI). These new rules have significant implications for cross-border estate planning and are discussed briefly in Section II.iv, but an in-depth discussion is beyond the scope of this chapter.

Although focus in the United States has been largely monopolised by the TCJA, a number of other developments in the past several years have had significant implications for wealthy families and their advisers. These include, for example, the enactment of the Foreign Account Tax Compliance Act (FATCA) in 2010, which increased transparency by requiring the cross-border exchange of tax-related information.

Another recent development aimed at increasing transparency is an Internal Revenue Service (IRS) regulation that treats a US disregarded entity wholly owned, directly or indirectly, by a non-resident alien as a domestic corporation separate from its owner for disclosure purposes under Section 6038A of the Internal Revenue Code of 1986, as amended. Under the rule, disregarded entities must now file IRS Form 5472 (which requires an employer identification number) when reportable transactions occur during the tax year and maintain records for reportable transactions involving the entities’ non-resident alien owners or other foreign parties. The disclosure rules are particularly relevant for non-resident aliens who wish to purchase real estate through a disregarded entity for privacy reasons. As such,
non-resident aliens should also be aware of the US Department of the Treasury Financial Crimes Enforcement Network’s (FinCEN) Geographic Targeting Order (GTO) that requires the disclosure of identifying information by any title company involved in a real property transaction on a FinCEN Form 8300 for qualifying transactions.

Perhaps the most dramatic force of change in the international private client world in recent years, and one in which the United States is not a participant, is the enactment of the Common Reporting Standard (CRS), the reciprocal automatic information exchange agreement developed by the Organisation for Economic Co-operation and Development that has been adopted in over 100 jurisdictions and is being phased into effect throughout 2018 in most participating jurisdictions. Under CRS, entities (including trusts and foundations) must report information on ‘controlling persons’. The broad reporting requirements create significant compliance burdens and challenges for trustees and financial institutions dealing with trusts. For entities, the controlling persons generally are the individuals who exercise control over the entity or who have a direct or indirect controlling ownership interest in the entity. For a trust, the controlling persons are defined to include the settlors, the trustees, the protectors (if any), the beneficiaries or class of beneficiaries, and any other natural persons exercising, directly or indirectly, control over the trust.

Although the United States is not a party to CRS, the global reach of CRS will make cooperation among teams of advisers across multiple relevant jurisdictions much more important. For example, US citizens and residents who are ‘controlling persons’ of non-US trusts will be required by trustees and financial institutions to provide ‘self-certification’ information, including their country of tax residence and tax identification numbers. US advisers involved in cross-border structuring will need to be mindful of CRS requirements and the residences of the various individuals involved in trust, foundation and similar structures. Some commentators have suggested that the United States has become an attractive jurisdiction for non-US persons wishing to maintain their privacy.

This chapter surveys tax liability, estate planning and wealth management under current US law. Section II of this chapter provides an overview of the US tax system for individuals, including income tax, transfer taxes, and reporting requirements for offshore assets. Section III summarises the laws of succession in the US, including the estate planning implications of marriage and divorce. Finally, Section IV discusses the different strategies of wealth management that can minimise US federal and state transfer taxes.

II TAX

i Income tax

US citizens (regardless of where they reside) and residents (collectively, US persons) are subject to US income tax on worldwide income. On the other hand, individuals who are neither citizens nor residents of the United States (non-resident aliens) are subject to US income tax only on certain types of US-sourced income, income effectively connected with a US trade or business and gains on the sale of US situs real property.

2 IRC Section 61. The top federal individual income tax rate for ordinary income in 2018 is 37 per cent, with a lower 20 per cent rate applied to long-term capital gains and qualified dividends. Net investment income may also be subject to an additional 3.8 per cent Medicare surtax.

3 IRC Sections 871, 897.
A non-citizen of the United States is considered a resident of the United States for income tax purposes if the individual:

\( a \) is admitted for permanent residence (i.e., holds a ‘green card’);
\( b \) elects to be treated as such; or
\( c \) has a ‘substantial presence’ in the United States in a given calendar year.\(^4\)

An individual satisfies the substantial presence test and is deemed a resident if he or she has been present in the United States for at least 31 days in the current year and for at least 183 days during a three-year period that includes the current year, determined based upon a weighted three-year average.\(^5\)

The use of this ‘weighted average’ can become a trap for individuals who focus only on the total day count and who believe that they can spend up to 182 days each year in the United States without having a ‘substantial presence’ that will cause them to be considered a US resident for income tax purposes. Under the weighted average test, a person may spend, on average, up to 120 days in the United States each year without being treated as a US income tax resident under the substantial presence test. An individual who meets the substantial presence test but spends less than 183 days in the United States in a year can still avoid being treated as a US income tax resident if he or she can establish that the individual maintains his or her tax home in another jurisdiction and maintains a ‘closer connection’ to such foreign tax home by filing a Form 8840 (Closer Connection Exception Statement for Aliens) with the IRS.\(^6\) It is also important to consider whether a non-US citizen may be entitled to protection under a tax treaty between the United States and the jurisdiction the individual considers to be his or her home.

### ii Gift, estate and GST tax

There are three types of US federal transfer taxes: estate tax, gift tax and generation-skipping transfer (GST) tax (collectively referred to as transfer taxes). US citizens and US residents are subject to transfer taxes on worldwide assets.\(^7\) The test to determine whether an individual is a US resident for transfer tax purposes is different from the test to determine whether an individual is a US resident for income tax purposes. Whereas the residence test for income tax purposes, as discussed above, is an objective test, residence for the purpose of transfer taxes is determined by a subjective domicile test, turning on the individual’s intentions. A person is a US resident for transfer tax purposes if he or she is domiciled in the United States at the time of the transfer.\(^8\) A person can acquire domicile in a place by living there, for even a short period of time, with the intention of remaining there indefinitely.\(^9\)

Subject to provisions of an applicable treaty, a non-US citizen who is not domiciled in the United States is subject to US transfer taxes only on property deemed situated in the United States (US situs assets), including US real estate (which includes condominium apartments).
and tangible personal property located in the United States. Shares in US corporations, debt obligations of US persons (subject to important exceptions for certain portfolio debt and bank deposits), and certain intangible property rights issued by or enforceable against US persons are subject to US estate tax but not US gift tax.

**Current income and transfer tax rates**

The TCJA modified the income limits and respective rates of the seven individual income tax brackets, mostly with the effect of decreasing the tax rate for each bracket. The top marginal rate was decreased from 39.6 per cent to 37 per cent for income in excess of US$500,000 for single filers and US$600,000 for married couples. The TCJA also increased the standard deduction from US$6,350 to US$12,000 for single filers and from US$12,700 to US$24,000 for married couples.

While the aforementioned changes implemented by the TCJA may reduce the federal tax liability of many taxpayers, other changes, such as the elimination of deductions previously available to taxpayers who itemise deductions, may increase federal taxes, especially for taxpayers who live in states and cities that have their own income taxes. For example, whereas individual taxpayers were previously able to take a deduction against their federal income tax liability for state and local taxes paid (including property taxes), the TCJA limits the allowable deduction for such taxes to US$10,000 for both single filers and married couples. In addition, the TCJA limits the mortgage interest deduction for mortgages incurred after 15 December 2017, such that the deduction is now allowed only for the interest on up to US$750,000 of the principal, including a home equity loan used to buy or improve a qualified residence. The TCJA increased the deductions for some charitable giving to public charities. Charitable contributions of cash to a public charity may be deducted up to 60 per cent of the donor’s adjusted gross income, while gifts of appreciated stock are subject to a 30 per cent deductibility threshold.

The lifetime exemption from US gift, estate and GST taxes for US citizens and residents was doubled by the TCJA to US$10 million (US$20 million for a married couple), indexed for inflation (for 2018, the indexed exemption is US$11.18 million for an individual and US$22.36 million for a married couple). The exemption reverts back to US$5 million (US$10 million for a married couple), indexed for inflation, after 2025. The top transfer tax rate remains at 40 per cent. The Treasury is expected to issue regulations to address any situations in which a gift is made utilising the increased exemption prior to 2025, but where the donor dies after the exemption amount reverts back to the lower amount.

US citizens and residents for transfer tax purposes may also take advantage of ‘portability’, which permits such persons to use the unused transfer tax exemption amount of the taxpayer’s deceased spouse (if he or she died after 31 December 2010). If a taxpayer is predeceased by more than one spouse, the taxpayer may use the unused transfer tax exemption of the last deceased spouse only. The executor of the deceased spouse’s estate must make an election on the deceased spouse’s estate tax return to allow the surviving spouse to use the deceased spouse’s unused transfer tax exemption. The estate of an individual who was a non-resident alien of the United States for transfer tax purposes at the time of such individual’s death is not

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10 Prior to the TCJA, the mortgage interest deduction was limited to the interest on up to US$1 million in mortgages to acquire or improve a qualified residence, in addition to the interest of up to US$100,000 on any home equity loan. Outstanding indebtedness may not be grandfathered for a home equity loan used for a purpose other than acquiring or improving a qualified residence.

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eligible to make a portability election, and thus such individual's lifetime exemption from US transfer taxes (which is only US$60,000) cannot be passed on to his or her surviving spouse. More significantly, a non-resident alien surviving spouse may not acquire his or her deceased US spouse’s unused lifetime exemption (except to the extent allowed under a US treaty).\(^\text{11}\) However, a surviving spouse who becomes a US citizen after the death of the deceased spouse may elect to use the unused transfer exemption of the deceased spouse.\(^\text{12}\)

### iii Medicare surcharge

The net investment income tax (NIIT) is part of the funding of Obamacare and dictates that citizens and residents of the United States (i.e., any individual other than a non-resident alien)\(^\text{13}\) must pay an additional 3.8 per cent Medicare tax on the lesser of the taxpayer’s ‘net investment income’, and the excess of the taxpayer’s modified adjusted gross income (as calculated for income tax purposes) for the taxable year over a certain threshold amount. Likewise, trusts and estates must pay an additional 3.8 per cent tax on the lesser of the trust’s ‘net investment income’, and the excess of adjusted gross income (as calculated by a trust or estate for other income tax purposes) over the dollar amount of the highest tax bracket for a trust or estate for the applicable tax year.\(^\text{14}\)

In general, net investment income includes three broad categories of income:

- **a** gross income from certain interest, dividends, annuities (including annuities received from a charitable remainder trust), royalties and rents;
- **b** gross income derived from a business in which the taxpayer does not materially participate (income from a trade or business that is a passive activity is subject to the NIIT) or from trading in financial instruments or commodities; and
- **c** net gains attributable to the disposition of property, other than property held in a trade or business not described in (a).

### iv Investment in non-US corporate entities

US citizens and income tax residents are subject to an anti-deferral tax regime if they invest (directly or indirectly) in non-US companies that are treated as CFCs or passive foreign investment companies (PFICs).

**Controlled foreign corporation**

A foreign corporation is a CFC if, at any time during the tax year, more than 50 per cent of its stock (by vote or value) is held by US taxpayers who directly, indirectly or by attribution hold 10 per cent or more of the voting power or value of the CFC. A CFC owned by a non-US trust is treated as owned by the trust’s respective beneficiaries, or, in the case of a grantor trust, by the trust’s grantor. Prior to the implementation of the TCJA, the rules only looked at voting power (as opposed to voting power or value) to determine if a taxpayer held...


\(^{13}\) A dual-resident US citizen (per IRC Section 301.7701(b)-&-(a)(1)), who declares resident status in a foreign country for tax purposes pursuant to an income tax treaty between the United States and that country and claims benefits of the treaty as a non-resident of the US, is considered a non-resident alien with respect to the NIIT.

\(^{14}\) US$12,500 for tax years beginning after 31 December 2016.
a 10 per cent interest in the corporation. The TCJA also expanded the ‘downward attribution’
rules that must now be considered in determining if an entity is owned 50 per cent or more
by US taxpayers. These new rules may make ‘accidental’ CFCs more common.

Significant US shareholders (i.e., US shareholders who own 10 per cent or more of the
vote or value) of a CFC are required to include in their gross income each year as ordinary
income their pro rata share of the CFC’s passive income (generally, dividends, interest,
royalties, gains from the sale of certain types of property), regardless of whether such US
shareholders actually receive any distributions. The TCJA also added a new ‘dry’ tax with
respect to GILTI.

In addition, under the old rules, a CFC had to be considered a CFC for at least a 30-day
period for significant US shareholders to be subject to the special tax charge described above.
The TCJA eliminated this provision, which could have significant impact on cross-border
CFC planning.

The TCJA also imposed a one-time ‘repatriation’ tax for 2017 on significant US
shareholders of CFCs with respect to the previously undistributed foreign earnings of
such entities.

**PFICs**

A foreign corporation is a PFIC if either 75 per cent of more of the gross income of such
corporation for the taxable year is passive income (the ‘income test’), or the average percentage
of the assets held by such corporation during the taxable year that produces passive income
or is held for the production of passive income is at least 50 per cent (the ‘asset test’). For
this purpose, passive income generally includes interest, dividends, rents and royalties, and
similar income and net gains from the sale of property producing such income. For example,
an investment in a non-US private equity fund could be treated as an investment in a PFIC.

When US shareholders of a PFIC dispose of their PFIC shares or receive an ‘excess’
distribution\(^{15}\) from the PFIC, any gain realised and any ‘excess’ distribution received is
treated as ordinary income and apportioned retroactively over the shareholder’s holding
period; and an interest charge is imposed with respect to tax payable on any gain attributed
to prior years. Importantly, this tax applies even where a US taxpayer holds his or her
interest in a PFIC indirectly (e.g., through a US or non-US flow-through entity). For
example, stock in a PFIC owned by a non-US non-grantor trust will be considered as owned
proportionately by its beneficiaries.

\(^{15}\) Generally, any distributions received by a US shareholder on PFIC stock in a taxable year that are greater
than 125 per cent of the average annual distributions received by the US shareholder on the shares in
the three preceding taxable years (or, if shorter, the US shareholder’s holding period in the shares) are
excess distributions.

v **Reporting requirements and penalties**

This section discusses a few of the US disclosure and reporting requirements that are of
particular interest to individuals with both US and international interests, but is not an
exhaustive list.
**IRS Forms 3520 and 3520-A**

A US person (including a US trust) who engages in certain transactions with a foreign trust, including creating a foreign trust (whether or not the trust has US beneficiaries) or transferring money or property, directly or indirectly, to a foreign trust; receives a distribution (including a loan) of any amount from a non-US grantor or non-grantor trust; or receives more than US$100,000 in gifts or bequests from a non-US person or a foreign estate or more than a specified amount (in 2017, US$15,797) from foreign corporations or foreign partnerships in any year, must report such amounts on IRS Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts).\(^\text{16}\) Such US person must file a Form 3520 for the year in which any such transfer, distribution, gift or bequest is made by the due date of such person’s federal income tax return for that year, even if the individual is not subject to US income tax on the amount.\(^\text{17}\) If an individual fails to file a required Form 3520, a penalty may be imposed in the amount of the greater of either US$10,000 or 35 percent of the gross value of the property transferred to a foreign trust for failure by a US transferor to report the creation of or transfer to a foreign trust; 35 percent of the gross value of the distributions received from a foreign trust for failure by a US person to report receipt of the distribution; or 5 percent of the gross value of the trust. Additional penalties for subsequent filing failures may follow.

In addition, the trustee of a foreign trust with a US owner must file Form 3520-A (Annual Information Return of Foreign Trust with a US Owner) for the US owner to satisfy its annual information reporting requirements.

**FBAR**

If a US person has a financial interest in or signature or other authority over any bank, securities, or other type of financial account outside of the US, and if the aggregate value of all such accounts exceeds US$10,000 at any time during the calendar year, that person must report such interest for such calendar year. Such report is made on FinCEN Form 114 (referred to as an FBAR form) on or before 15 April of the succeeding year, with a potential six-month filing extension. For purposes of the FBAR rules, a US person is considered to have a financial interest in an account where title to the account is held by a grantor trust and such US person is the grantor of such trust. A US person is also deemed to have a financial interest in an account owned by a trust in which the US person has a present beneficial interest in more than 50 percent of the assets or current income. Such beneficiary is, however, not required to report the trust’s foreign financial accounts on an FBAR form if the trust, trustee of the trust, or agent of the trust is a US person and files an FBAR disclosing the trust’s foreign financial accounts.

A beneficiary of a discretionary trust should not generally be considered as having a financial interest in such trust requiring an FBAR filing merely because of such person’s status as a discretionary beneficiary.

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\(^{16}\) If the trust owns an interest in a CFC or a PFIC, a US beneficiary may have additional reporting requirements.

\(^{17}\) US law requires a US beneficiary of a non-US trust to obtain from the trustee of a non-US trust a detailed statement of distributions made from the trust to enable the US beneficiary to complete the Form 3520. If such a statement is not filed with the IRS, the distribution could be treated for US income tax purposes as being a distribution of undistributed net income.
FATCA

FATCA helped accelerate the global drive towards greater transparency and scrutiny of offshore assets. Under FATCA, enacted in 2010 as part of the Hiring Incentives to Restore Employment Act, foreign financial institutions (FFIs) are required to either enter into an agreement with the IRS under which they agree to report to the IRS certain details about their accounts directly or indirectly held by US persons (US accounts) or become ‘deemed compliant’ under the regulations. Non-financial foreign entities (NFFEs) that are publicly traded or engaged in active trading are not required to enter into or comply with an FFI agreement. However, FATCA does require certain ‘passive NFFEs’ (generally NFFEs earning mostly passive income that are not publicly traded) to report to withholding agents and participating FFIs with which the NFFE holds accounts, information on their ‘substantial US owners’ (described in footnote 16), or to certify annually that they have no substantial US owners. FATCA is being implemented in stages as provided in the final regulations released in 2013. Because the United States does not have direct jurisdiction over most FFIs, FATCA compels compliance by imposing a 30 per cent withholding tax on US-sourced income earned after 30 June 2014 and proceeds from the sale of US property after 31 December 2016 on all FFIs that do not agree to provide the IRS with the required information.

The definition of an FFI is broad, including any entity that ‘accepts deposits in the ordinary course of a banking or similar business’, holds financial assets for the account of others ‘as a substantial part of its business’, or is engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interests therein and would include most investment vehicles unless a specific exception applies. Under this definition, foreign trusts with corporate trustees acting for different customers (including, in most cases, a private trust company that retains outside investment advisers or receives fees for its services) will be FFIs if, in general, 50 per cent or more of the trust’s gross income is attributable to investing in financial assets. A foreign trust that is not an FFI (for instance, a trust managed by an individual trustee) will generally be an NFFE.

Since the implementation of FATCA began, the Treasury Department has entered into many intergovernmental agreements (IGAs) to facilitate the implementation of FATCA. The purpose of IGAs is to remove domestic legal impediments to compliance with FATCA.

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18 US accounts include accounts held by US-owned entities. IRC Section 1471(d)(1). A US-owned entity is an entity with ‘Substantial US Owners’. IRC Section 1471(d)(3). Generally, an entity has Substantial US Owners if a US person owns more than a 10 per cent interest in the entity. IRC Section 1473(2)(A). However, in the case of investment entities, any US ownership will cause it to be a US-owned foreign entity. IRC Section 1473(2)(B). A foreign non-grantor trust would be a US-owned entity if any specified US person holds, directly or indirectly, more than 10 per cent of the beneficial interest in the trust. IRC Section 1473(2)(A)(iii).

19 IRC Section 1473(2)(A); Treas. Reg. Section 1.1471-4(d)(iii)(B)(3). As an alternative, the regulations permit an NFFE to report directly to the IRS certain information about its direct or indirect substantial US owners, rather than to a withholding agent, by electing to become a ‘direct reporting NFFE’. IRC Section 1471(a)-(b). Withholding on the gross proceeds from the sale or other disposition of property of a type that can produce interest or dividends or dividends that are US-source fixed, determinable, annual or periodical income will begin for sales occurring after 31 December 2018. Although FATCA imposes significant compliance and administrative burdens on trustees of non-US trusts, there should be no additional tax burden imposed if trustees comply with all reporting requirements.

20 IRC Section 1471(d)-(5).

21 Treas. Reg. Section 1.1471-5(e)(4).
requirements and to reduce burdens on FFIs located in jurisdictions that enter into IGAs (partner jurisdictions). There are two models of IGAs. Under the Model 1 IGAs, covered FFIs report FATCA information to government agencies in their own jurisdiction, which then transmits the information to the IRS. Under the Model 2 IGAs, a partner jurisdiction agrees to facilitate FATCA compliance by its resident FFIs, but those FFIs generally must still register with the IRS and report information about US accounts directly to the IRS.

Despite early opposition to FATCA in many cases, partner jurisdictions are entering into bilateral IGAs whereby they will provide information to the United States in exchange for an agreement from the United States to provide such partner jurisdiction with FATCA-like information regarding financial accounts held by the citizens of such partner jurisdiction in the United States. Despite early predictions from some that FATCA would isolate the United States, to a large extent FATCA appears to be evolving into one part of a global system of mutual information sharing, although the impact of FATCA on the willingness of non-US entities to invest in US assets remains to be seen.

Despite growing international acceptance of FATCA, aspects of its implementation remain contentious. For example, the National Taxpayer Advocate urged the IRS to develop fact-specific guidelines that explain how benign non-filers can obtain a finding of reasonable cause. Critics continue to claim that the reporting requirements are too burdensome and inefficient, especially because some estimates indicate that the cost of enforcing FATCA may be higher than the revenue produced by it. Additionally, some signs of push-back are emerging, such as certain non-US financial institutions’ reluctance or flat refusal to take on new US clients.23

**Form 8938**

In addition to the reporting and withholding requirements discussed above, FATCA also requires certain individual taxpayers, including US citizens or green card holders permanently residing abroad, with interests in certain foreign financial assets with an aggregate value greater than US$50,000 on the last day of the tax year, or greater than US$75,000 at any time during the tax year, to file Form 8938 (Statement of Specified Foreign Financial Assets), reporting the interest with such individual’s federal income tax return. The obligation to file Form 8938 is in addition to, not in replacement of, any filing obligation such individual may have under the FBAR rules. Whether a US person beneficiary of a discretionary non-US trust will be required to report his or her interest in the trust on a Form 8938 will depend on many factors, including whether such individual received a distribution from the trust in a given tax year and the value of the individual’s interest in other foreign financial assets.

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Form 5472

Generally, except in the case of corporations (or entities that elect to be treated as corporations), a US entity that has a single owner is disregarded as separate from its owner. However, in late 2016, the IRS finalised regulations that treat a US disregarded entity wholly owned, directly or indirectly, by a non-resident alien as a domestic corporation separate from its owner for Code Section 6038A disclosure purposes. This change means that such entities are required to make additional disclosures when participating in certain transactions.

Under the current rule, these entities must file IRS Form 5472 (which requires an employer identification number) when reportable transactions occur during the tax year, and must maintain records of reportable transactions involving the entities’ non-resident alien owners or other foreign parties. The regulation classifies transactions such as any sale, lease, or other transfer of any interest in or a right to use any property as reportable transactions. In order to acquire an employer identification number, the owner may have to obtain an individual taxpayer identification number (as they also would when buying property individually), which many non-resident aliens hope to avoid. These disclosure rules are particularly relevant for non-resident aliens who wish to purchase real estate through a disregarded entity for privacy reasons. As such, non-resident aliens should also be aware of a new FinCEN GTO that requires the disclosure by the title company involved in the transaction of identifying information on a FinCEN Form 8300 for qualifying transactions. The GTO’s disclosure requirements are applicable to all purchases paid for by cash, cheque, money order or a funds transfer (and without a bank loan or other similar form of financing) of:

a. US$500,000 or more in Bexar County, Texas;
b. US$1 million or more in Miami-Dade, Broward and Palm Beach counties in Florida;
c. US$1.5 million or more in the boroughs of Brooklyn, Queens, Bronx or Staten Island in New York City, New York;
d. US$2 million or more in San Diego, Los Angeles, San Francisco, San Mateo or Santa Clara counties in California;
e. US$3 million or more in the borough of Manhattan in New York City, New York; and
f. US$3 million or more in the city and county of Honolulu in Hawaii.

A Form 8300 must include information about the identity of the purchaser, the purchaser’s representative, and the beneficial owners, as well as information about the transaction itself, including the closing date, payment amount, purchase price and address of the real property involved in the transaction. In addition, the form requires disclosures about the entity used to purchase the property, including the names, addresses and taxpayer identification numbers for all members, and the reporter must obtain copies of driver’s licences, passports or similar documents from the purchaser, the purchaser’s representative and the beneficial owners.

The purpose of the GTO is to provide law enforcement with data to improve efforts to address money laundering in the real estate sector. The GTO is a temporary measure that is effective for only 180 days, but has been extended four times, with the current extension set to expire on 16 September 2018.

**Form 5471**

Form 5471, Information Return of US Persons With Respect to Certain Foreign Corporations, must be filed by, among others, US persons who own or acquire certain interests in foreign corporations, including CFCs.

**Form 8621**

A US shareholder who directly or indirectly owns shares in a PFIC at any time during such person's taxable year must file a Form 8621. The filing requirement is imposed on the first US person in the chain of ownership (i.e., the lowest-tier US person) that is a PFIC shareholder (including an indirect shareholder).

### III SUCCESSION

#### i Overview

**State jurisdiction**

In the United States, state law determines how and to whom property will be distributed upon death. Succession law thus varies from state to state, but the fundamental principle underlying US succession law is testamentary freedom, with some exceptions discussed below. The testator's freedom to determine the disposition of property at death generally manifests through a will and will substitutes (such as revocable *inter vivos* trusts, contracts, life insurance policies, pension plans and joint accounts). Intestacy statutes provide a default framework for assets not otherwise disposed of by the decedent.

**Estate administration**

Following an individual’s death, his or her will, if any, is submitted to a state probate court, which validates the will, confirms fiduciary appointments and generally supervises the administration of the estate. As part of the probate process, the will and ancillary documents, which may include a detailed inventory of probate assets, generally become a matter of public record, but this may vary among states. Assets that pass to the surviving joint tenants or by contractual beneficiary designation are considered non-probate assets and therefore are not subject to the probate court process, although such assets generally are still subject to estate tax.26

Because of the potential delay, cost and lack of privacy often associated with the probate process, US citizens are increasingly relying on will substitutes, such as revocable *inter vivos*

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26 Examples of non-probate assets include the following: property owned and held in joint tenancy, tenancy by the entirety or, in certain states, community property with the right of survivorship; property transferred into an *inter vivos* trust prior to the settlor’s death; real property subject to transfer under a transfer-on-death deed; assets held in a pay-on-death account or ‘Totten trust’ bank account; proceeds of a life insurance policy; and individual retirement accounts with a named beneficiary.
trusts, which function similarly to a will in that beneficiaries generally receive assets at the
donor’s death but differ in that such assets pass pursuant to the existing trust deed, thereby
avoiding the need for probate.

If an individual dies without a will and thus dies ‘intestate’, or dies with a will that fails
to dispose of all probate assets, the relevant state court appoints an individual, typically the
surviving spouse or children, to administer and distribute the intestate property pursuant to
the state’s intestacy statute.

ii  Property division at death

Elective share right of surviving spouse
While testamentary freedom is the linchpin of US succession law, that freedom is not unfettered.
In fact, states have enacted increasingly generous provisions for surviving spouses, often at the
expense of surviving children and notwithstanding the testator’s express declarations to the
contrary. Virtually all US jurisdictions protect against spousal disinheretance either through
community property concepts or elective share laws that entitle spouses to a ‘forced’ share of
the decedent spouse’s estate.27 Although state law varies widely in the amount of the elective
share and the variables (length of marriage, presence of minor children, surviving spouse’s net
worth, etc.) used to determine such amount, most states set the amount between one-third
and one-half of the decedent’s estate.28 Spouses in New York, for example, may choose to take
the greater of US$50,000 (or, if the net estate is valued at less than US$50,000, the entire net
estate) or a third of the decedent spouse’s net estate in lieu of taking benefits under a will.29
The amount that passes as the elective share generally qualifies for the marital deduction for
federal and state estate tax purposes.30

No forced heirship right of children
Unlike many civil law systems, no US jurisdiction (with the sole exception of Louisiana,
whose laws are predominantly derived from the French Napoleonic Code)31 recognises forced
heirship rights of children. Thus, although testators cannot disinherit spouses, they can freely
disinherit children. Even citizens or domiciled individuals of countries that recognise forced
heirship rights (such as Switzerland and France) may be able to defeat forced heirship claims
with respect to US situs assets by moving such assets to states such as New York, New Jersey
or Connecticut (to name a few) that permit non-domiciled individuals to elect to have local

27 Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin have
community property laws, while the remaining states have elective share laws (Alaska is an opt-in
community property state that gives both parties the option to make their property community property).
Georgia currently is the only state that does not recognise dower or curtesy, community property or elective
(2011).
28 Note that in the event of intestacy, each state’s intestacy statute will determine the amount to which the
surviving spouse is entitled. Elective share laws are thus generally relevant only when a surviving spouse
receives less under the decedent spouse’s will than what he or she is entitled to receive as the elective share.
29 NY Estates, Powers and Trusts Law (EPTL) Section 5-1.1-A(a)(2).
30 Diane Hubbard Kennedy, ‘Using the Marital Deduction’, ALI-ABA Estate Planning Course Materials
Journal at 27 (April 2000).
31 Article 1493 of the Louisiana Civil Code.
law govern the disposition of property located within that state. The decision in *Matter of Renard*, the seminal case involving forced heirship, illustrates this principle. In that case, New York’s highest court upheld a French-domiciled individual’s choice of law direction to have New York law govern the disposition of her assets situated in New York (where she resided for several decades before returning to her native France, leaving behind several financial accounts), thereby defeating her son’s claims to a forced share in such assets under French forced heirship law.

**Succession on intestacy**

When the wishes of a decedent are not expressly known (that is, when the decedent dies without a will or has a will that fails to dispose of all probate property), state intestacy statutes mandate how the decedent’s estate will be divided. These statutes are intended to approximate the ‘presumed will’ of the decedent by enforcing a distributive scheme that the decedent would likely have chosen. Typically, surviving spouses receive a preferential disposition (in some cases, the entirety of the estate) and the balance thereafter, if any, passes to children or, if there are none, to more remote descendants or other family members.

### iii Applicable developments affecting succession

**Definition of marriage**

The Supreme Court in its 2015 decision in *Obergefell v. Hodges* held that states must license marriages between same-sex couples and recognize same-sex marriages performed in other states. (Two years earlier, in *United States v. Windsor*, the Supreme Court invalidated Section 3 of the Defense of Marriage Act (DOMA), which limited the definition of marriage for the purposes of federal law to opposite-sex couples.) Consequently, the tax benefits provided to married couples under state and federal laws are now available to same-sex couples. Under federal law, these benefits include the ability to utilize the unlimited marital estate tax deduction, split gifts and elect portability. Under state law, same-sex couples should now have succession rights, such as spousal elective share rights, intestate inheritance rights and fiduciary appointments over intestate estates. It should be noted that, while this decision has nationwide impact, it must be implemented at the state level. In light of these changes, same-sex couples may wish to re-examine estate and tax planning done before the repeal of DOMA and the elimination of same-sex marriage bans. For example, same-sex couples may be able to amend past income tax returns for open tax years to elect married filing jointly status, which may result in a lower effective rate of tax. In addition, it is important to note that neither *Obergefell* nor *Windsor* altered the legal status of domestic partnerships or civil unions. Thus, although civil unions and domestic partnerships confer spousal-like benefits in some states, same-sex couples must marry if they wish to guarantee that their partnerships are on an equal footing with opposite-sex marriages.

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Property division on divorce

Under the laws of most states, property acquired or earned by either spouse during marriage is generally considered marital property (or community property), whereas property acquired prior to marriage, acquired by gift or inherited (whether outright or in trust) is considered separate property. As a general rule, an individual’s separate property is not subject to equitable distribution in a divorce proceeding. But conceptions of what types of property should be taken into account in determining equitable distribution of marital property in the event of divorce have changed over time, with some courts taking into account the value of an individual’s separate property in determining what constitutes an equitable distribution of marital property and in setting the amount of spousal maintenance payments.

Moreover, in some states, ‘interests’ in trusts may be considered part of the marital estate in determining the equitable distribution award if the receiving party has a ‘sufficiently concrete, reasonable and justifiable expectation’ of a benefit attached to such interests. This is an evolving area of the law, and it is important to bear in mind that the protection of assets held in trust may be eroding in some states in the divorce context.

Notably, New York courts have in the past taken into account intangible assets, such as business goodwill, professional licences and educational degrees, for the purposes of measuring a spouse’s ‘increased earning capacity’ to value marital property and determine maintenance awards. In 2016, the New York legislature enacted a law that overturned case law that counted enhanced earning capacity as marital property, but the new law does permit courts to take contributions to a spouse’s enhanced earning capacity into account when deciding on the equitable distribution of marital property.

IV WEALTH STRUCTURING AND REGULATION

This section focuses on domestic planning strategies for US persons. It provides a short discussion of ‘pre-immigration’ planning for non-resident aliens of the United States who wish to become US residents or citizens. Pre-immigration planning is a separate and complex area and an in-depth discussion is beyond the scope of this chapter.

There are several planning strategies that can be utilised to minimise the effect of US federal and state estate taxes. Lifetime irrevocable trusts are the most popular tool because of the many advantages to making gifts during life, including, for example:

- the avoidance of state transfer tax in jurisdictions with an estate tax, but no gift tax;

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34 The TCJA eliminated the deduction for alimony paid under a divorce settlement executed or modified in 2019 or later. Alimony payments will no longer be taxable income for their recipients.

35 Bender v. Bender, 258 Conn. 733, 747-49 (2001) (where court stated that ‘sources of deferred income, such as pension benefits and trust interests, whether vested or not, constitute property subject to distribution, provided that the contingent nature of the interest does not render the interest a mere expectancy’); see also SL v. RL, 55 Mass. App. Ct. 880, 884, 774 N.E.2d 1179, 1182 (2002) (where court held that the wife’s future interest in certain non-marital trusts ‘was’ subject only to her surviving her [then living] mother, a condition [that Massachusetts precedent] considered not to bar inclusion within the marital estate’); In re Marriage of Rhinehart, 704 N.W.2d 677 (Iowa 2005) (where court held that undistributed income from an irrevocable trust was not a marital asset that was subject to division, but that the wife’s future interest in such trust could be considered when determining equitable division of property).

36 IRC Sections 671–79.

37 IRC Sections 671–79.
the federal gift tax is tax-exclusive, which means that an individual does not pay tax on the gift tax, whereas the federal estate tax is tax-inclusive, which means a decedent’s estate pays tax on the portion of the estate used to pay estate tax; and

c all the appreciation on assets after the gift is made is outside of the taxable estate at death.

The uncertain future of the US$5 million exemption from US gift, estate and GST taxes caused many individuals to make lifetime exemption gifts before year-end 2012, and the sunset of the increased exemption implemented by the TCJA may again result in a rush on lifetime gifting.

Grantor trusts

Many high net worth individuals choose to set up trusts for their children and further descendants and fund them with some or all of the lifetime gift and GST tax exemption. The benefits of such trusts can be leveraged if they are structured as grantor trusts, which are trusts over which the individual funding the trust (the grantor) retains certain powers (e.g., the power to substitute assets of equal value for the trust assets) that cause the grantor to be treated as the owner of the trust assets for income tax purposes (but not for estate and gift tax purposes). Because the grantor of such a trust is legally responsible for payment of the income taxes on the trust’s income, the payment of such taxes would not be deemed a further gift to the trust, thereby enabling the trust to grow on an income tax-free basis. If properly drafted, the grantor trust status may be cancelled at any time if the tax burden becomes too great.

Making a loan to a grantor trust at a low rate of interest is another means to leverage the benefits of such a trust. If the trust’s investments perform better than the applicable interest rate set by the IRS, the excess appreciation remains in the trust with no gift tax consequences. In addition, the grantor may sell to the trust assets that are expected to appreciate in exchange for consideration of equal value (including the trust’s promissory note). A transfer by sale would remove the assets sold to the trust and any appreciation thereon from the grantor’s estate, although the sale proceeds paid to the grantor would remain part of his or her estate. If the assets sold to the trust appreciate at a greater rate than the sale proceeds, the appreciation would have been passed to the grantor trust without the imposition of estate or gift tax. Because a grantor trust is considered to be owned by the grantor for income tax purposes, there would be no income tax consequences on the sale to the trust, or on the payment of interest under a loan during the grantor’s lifetime.

The IRS has made attempts to challenge the use of sales to grantor trusts. To date, those attempts have generally been unsuccessful, but the IRS seems to have renewed its efforts in two companion cases before the Tax Court, Estate of Donald Woelbing v. Commissioner and Estate of Marion Woelbing v. Commissioner. Accordingly, practitioners should be aware of the dialogue on this subject.

38 IRC Sections 671–79.
39 IRC Section 671.
41 Estate of Donald Woelbing v. Comm’r, TC Docket No. 30261-13; Estate of Marion Woelbing v. Comm’r, TC Docket No. 30260-13 (both filed 26 December 2013). Settlement was reached in Donald Woelbing on 24 March 2016 and in Marion Woelbing on 28 March 2016.
ii  Grantor-retained annuity trusts

A grantor-retained annuity trust (GRAT) is a statutorily authorised trust that allows a grantor to transfer the appreciation in the value of property above a fixed interest rate during a specified period at a nominal gift tax cost.\(^{42}\) The grantor retains the right to receive an annuity for a specified period of years (for example, two years) equal to the value of the assets transferred to the GRAT at the time of funding, plus a fixed interest rate set by the IRS.\(^{43}\) The annuity can be paid in cash or in kind. At the end of the term of years, the remaining assets of the trust (i.e., the appreciation in the value of the GRAT assets during the GRAT term over the fixed interest rate), pass to the designated remainder beneficiaries (usually one or more trusts for the grantor's children). If the assets appreciate at a higher rate than the statutory rate of return, that appreciation is transferred at the end of the GRAT term to the designated remainder beneficiaries with no estate or gift tax. If the GRAT is unsuccessful, the grantor (or the grantor's estate) receives back the remaining GRAT assets and the remainder beneficiaries have no obligation to repay any shortfall.\(^{44}\) GRATs are powerful tools because they may pass assets with very little added risk. However, the need to pay annuity amounts requires a valuation of the asset used to fund the GRAT at formation and on each annuity date. For this reason, GRATs are often (though not always) funded with marketable securities, the value of which is easy to determine and not likely to be challenged by the IRS.

iii  Partnerships

Interests in partnerships may be either given or sold to family trusts to facilitate the transfer, ownership and management of certain assets. Such partnerships are often referred to as ‘family limited partnerships’ (FLPs) because they permit several family members and entities to pool their assets and make investments that might not be available to some family members or entities (e.g., owing to securities laws that require investors in certain products to have a certain minimum net worth). In the case of a sale or gift of an FLP interest, the value of the transferred interest should be determined by a professional appraiser. It can be expected that the FLP interest given or sold would be valued by an appraiser at a lower value than the sum of the underlying assets to reflect that the interest being transferred is a minority, unmarketable interest, and also to reflect illiquidity caused by any restrictions placed on the transfer of such interests by the FLP's operating agreement.

FLPs generally are not appropriate vehicles for residences or other personal assets that will be used by family members. They continue to be scrutinised by the IRS and may cause adverse tax consequences if they are found to have no apparent business or other non-tax purpose, or where the individual funding the FLP exercises control over the underlying assets.

\(^{42}\) See IRC Section 2702.
\(^{43}\) IRC Section 2702(b); Treas. Reg. Section 25.2702-3.
\(^{44}\) Treas. Reg. Section 20.2036-1(c)(2)(i).
without respecting the entity formalities. However, when an FLP is properly structured and administered, taxpayers have been successful in defeating these challenges. Moreover, the IRS may assert that the discount applied to the FLP assets is overstated.

iv Pre-immigration planning

Non-US residents who plan to become US residents in the future should undertake pre-immigration planning to protect their assets from the potential application of US tax laws. Pre-immigration planning is a complex area that often involves both US and non-US trusts, careful planning to obtain a step-up in capital gains basis of assets, and other sophisticated planning tools. Pre-immigration planning should begin as soon as possible for individuals planning to become US residents. If a non-US grantor of a non-US trust, with one or more US beneficiaries, becomes a US resident within five years of funding the trust, the grantor becomes subject to US income tax on all of the trust’s income and on capital gains for any year in which the trust had a US beneficiary. The trust also becomes subject to increased reporting obligations.

V OUTLOOK AND CONCLUSIONS

The urgent need for tax revenue, coupled with the US government’s distrust of the offshore world, shows no sign of abating. As many governments worldwide share those driving forces, all indicators point to an increasingly global system of information sharing and enforcement.

45 See, e.g., Estate of Turner II, 138 TC 306 (2012) (consolidated asset management generally is not a significant non-tax purpose for a taxpayer’s formation of an FLP).
46 See, e.g., Estate of Stone, TC Memo 2012-48 (holding that the decedent had two non-tax motives for the establishment of an FLP owning woodland parcels: (1) to create a family asset that would later be developed and sold by the family; and (2) to protect the land from partition actions).
47 Estate of Koons v. Comm’r, TC Memo 2013-94 (rejecting estate expert’s regression analysis as overstating the marketability discount as 31.7 per cent and adopting IRS’s expert discount of 7.5 per cent instead); Holman v. Comm’r, 130 T.C. 170 (2008) (IRS successfully argued that the appropriate discount for lack of control and lack of marketability should be roughly half the discount claimed by the taxpayers).
Appendix 1

ABOUT THE AUTHORS

PABLO ALARCÓN
Alarcón Espinosa Abogados
Pablo Alarcón gained his law degree in 1986 from Universidad Pontificia de Comillas, and his area of expertise is tax law.

Mr Alarcón was a partner in the legal and taxation department of Ernst & Young in Madrid until 1998, and from 1998 to 2000 he held the posts of secretary of the board of directors and asset planning manager of UBS España, SA. He joined Gómez-Acebo & Pombo in September 2000 and was a partner at the firm from 2002 to 2010. He is the founder of his own law firm. He has made various contributions to specialised publications and journals.

He has been a member of the Madrid Bar Association since 1986, and is also a member of the International Bar Association, American Bar Association, Association of Tax Professionals and International Tax Specialists Group.

Mr Alarcón has been teaching international taxation for many years at the IE University and Law School where he is academic director of the Global Tax Law master’s programme.

ALEC R ANDERSON
Conyers Dill & Pearman
Alec R Anderson is global head of the trust and private client group and a director in the Bermudian office of Conyers Dill & Pearman. He joined Conyers in 1985 and became a partner in 1991. He is also a director and president of Codan Trust Company Limited, a licensed trust company and a controlled affiliate of Conyers Dill & Pearman.

Mr Anderson’s practice includes trust and estate planning for international private clients and advising on various cross-border transactions involving trusts, especially the restructuring, modification and variation of trusts. He also has expertise in trust dispute resolution and assisting mediated resolution of contentious trust matters. Additionally, his practice includes involvement in the protection of family wealth from divorce and other litigation.

Mr Anderson is a regular speaker at conferences and contributor to many trade and legal publications. He has published several chapters in books on trust and private client practice in Bermuda. He is the Bermudian editor of the journal Trusts & Trustees. He is also the chairman of the Bermuda Trust Law Reform Committee. Mr Anderson has been recognised as a leading private client lawyer by Chambers Global, which ranks Mr Anderson in band 1 for international private client work and notes that he is described by sources as ‘top of the top-tier lawyers’.

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FERENC BALLEGEER  
*FB-Private Wealth Law*

Ferenc Ballegeer has been a lawyer since 2001 and is a member of the Brussels Bar. Ferenc founded FB-Private Wealth Law in 2012. FB-Private Wealth Law assists international and Belgian private clients, expats and their families with regard to tax law and estate planning. Ferenc is an active member of the International Association of Young Lawyers and chairs the Regional Taxes Task Force of the American Chamber of Commerce in Belgium. He is invited regularly as a speaker on estate planning and tax topics. He is also admitted on the EU-list of the Luxembourg Bar. In Luxembourg he is counsel at Brucher, Thieltgen & Partners.

MARK BARMES  
*Lenz & Staehelin*

Mark Barmes is a member of the private client practice group of Lenz & Staehelin and former head of the group in the Geneva office. He advises individuals and trustees on all aspects of wealth planning in both international and domestic contexts. He particularly assists foreign private clients and trustees to establish themselves in Switzerland and to resolve disagreements. He is on the board of Swiss trustee companies and contributes actively in the field of wealth planning in Switzerland through membership and lecturing for the Society of Trust and Estate Practitioners and as a committee member of the Swiss Association of Trust Companies.

STEPHANIE C BERNARD  
*Conyers Dill & Pearman*

Stephanie C Bernard is an associate in the trust and private client group in the Bermudian office of Conyers Dill & Pearman.

Ms Bernard’s practice covers all aspects of trust law with specialised expertise in international and local estate planning arrangements and pensions.

Ms Bernard co-authored the Bermuda chapter of *The World Trust Survey* (published by Oxford University Press) and was recognised in the 2017 edition of *Legal 500 Bermuda Private Client and Trust*.

MARK BIDDLECOMBE  
*Nerine Trust Company Limited*

Mark Biddlecombe LLB, ACIB, BSc, TEP, has been involved in the fiduciary services industry since 1991. Qualified as a barrister and as a solicitor, and a full member of STEP, Mark has devoted his career to looking after the interests of high net worth individuals and families.

Mark has a broad international experience, and has worked in Jersey, Singapore and London, working for trust companies, law firms and accountants, giving him a broad perspective on the needs of the international private client.

Mark is group in-house legal counsel for Nerine, and a director of Nerine’s holding company. He also holds board positions on a select number of external boards.
KATHARINA BINDER

*DORDA Rechtsanwälte GmbH*

Katharina Binder has almost 10 years of experience in corporate law, tax and private client matters and is an expert in trust and estates and international corporate restructurings. She graduated from the University of Vienna (Mag iur 2005) and from Fordham University School of Law (LLM *magna cum laude* 2011). She has been admitted to the New York Bar since 2012.

Katharina Binder first joined DORDA as an associate in 2007 before she went to NYC to pursue her LLM degree in International Business and Trade Law. She rejoined DORDA in 2014 after having worked at the tax desk of another leading, internationally renowned law firm in Vienna (2012–2014). Katharina Binder is a member of AIJA and the author of several publications on private foundations and cross-border corporate restructurings.

CRAIG BROWN

*First Names Group*

Craig Brown is the managing director of First Names Group in the Isle of Man, with over two decades of experience in the financial and fiduciary sectors. In his current role, Craig ensures that the multiple client services teams operating from the group’s Manx office work together to consistently deliver the very best in trust and corporate solutions for its diverse international client base. He has particular expertise in asset protection, cross-border structuring and entrepreneurial business. Prior to joining First Names Group as a client services director in 2013, Craig held a number of senior posts, including director and MD for fiduciary and corporate services providers, and head of tax for a global oilfield services company. A chartered accountant (fellow) and a chartered tax adviser, Craig attained these qualifications while training with Arthur Andersen. He also has a Masters in Engineering from the University of Cambridge.

PABLO CHECHILNITZKY R

*Recabarren & Asociados*

Pablo is a partner at Recabarren & Asociados with extensive experience in tax planning and restructuring, both for legal entities and individuals. He holds an LLM degree from Northwestern University, Pritzker School of Law (Chicago, US) and a Certificate in Business Administration from Northwestern University, Kellogg School of Management (Chicago, US).

JEAN-PHILIPPE CHETCUTI

*Chetcuti Cauchi Advocates*

Jean-Philippe is co-founder and managing partner of Chetcuti Cauchi Advocates. He has significant experience in advising local and foreign corporations and investors in Europe, and acts as legal counsel and tax consultant to individuals, business families and companies seeking a tax-efficient commercial or residential base in Malta or Cyprus. His main specialisation is supporting ultra-high net worth individuals and private clients in relation to their immigration and estate planning requirements.
Jean-Philippe is recognised for his in-depth experience in trust and estate administration and corporate and asset protection structures, and for his handling of sophisticated domestic and international transactions. He is a key adviser in European citizenship by investment programmes and acts for family offices around the globe.

His leadership is especially recognised in the area of Maltese immigration law and he has represented a number of professional associations on policy reform issues concerning Malta’s attractiveness for foreign retirees and expatriates.

GEOFFREY CONE
Cone Marshall Limited
Geoffrey Cone graduated from the University of Otago, New Zealand with LLB honours and a postgraduate diploma in tax and trust law. He commenced practice in 1980 in Auckland, New Zealand, then moved to Christchurch, where he was a partner and the chairman of partners in a leading law firm. There he practised in commercial litigation as well as tax and trust advisory work and appeared in the courts at all levels as leading counsel, including the Privy Council. After working in the British West Indies as a litigator for two years he returned to practise in 1997 in Auckland, following which he established his own practice in 1999. His firm, Cone Marshall Limited, is the only New Zealand law firm to specialise exclusively in international trust and tax planning, and it provides trustee and trust management services through its affiliated companies. He is a member of STEP.

KEITH CORBIN
Nerine Trust Company Limited
Keith Corbin ACIB, TEP, has been involved in the international fiduciary services industry for over 40 years, during which time he has managed operations in a number of major international finance centres.

He is the executive chairman of the Nerine Group of Fiduciaries, which has offices in the BVI, Guernsey, Switzerland, Hong Kong and India, where Nerine became the first independent trust company to establish a presence.

Keith also serves as independent director of public and private companies outside of the Nerine Group and these appointments include the chairmanship of board committees. He has also served as chairman or committee member of various industry bodies.

RUTH CORNETT
Christie’s
Prior to joining Christie’s, Ruth Cornett worked as a tax adviser in a number of professional firms in the City and the West End of London. After training as an art historian and working as a curator in the V&A, Ruth changed careers in 1992, studying law and qualifying as a chartered tax adviser in 1998 and as a trust and estate practitioner in 2008.

Ruth advises a broad spectrum of clients on a range of tax matters with a particular emphasis on the taxation of chattels, capital gains tax and inheritance tax. Ruth also serves as an observer on the Historic Houses Association tax and political committee and has lectured for the Society of Trust and Estate Practitioners and Christie’s Education.
EMILY DEANE
STEP
Emily Deane TEP is technical counsel at STEP. She graduated from Keele University with a BA (Hons) in English and subsequently from Westminster University with a Graduate Diploma in Law. She was admitted to the Roll of Solicitors in England & Wales in 2005 and she has practised as a private client and trust solicitor since qualifying. In recent years she has been based in Bermuda and the Cayman Islands, specialising in all aspects of the private client industry, including wills, property, tax planning, estate administration, and onshore and offshore trusts and litigation.

KATHERINE DEMAMIEL
Sullivan & Cromwell LLP
Katherine DeMamiel is an associate in the New York and London offices of Sullivan & Cromwell’s estates and personal group. Ms DeMamiel received her JD from the University of Virginia School of Law in 2010 and her BA from Baylor University in 2007. She has participated in the representation of international families and fiduciaries with respect to a broad range of tax and planning issues, including extensive advice with respect to trust and family business planning. Ms DeMamiel is a co-author of the article entitled ‘Planning for the Non-Citizen Spouse’ published in the June 2016 edition of the Journal of Taxation, and was named as a ‘One to Watch’ in the Private Client Global Elite 2017 and 2018 by Legal Week.

IAN DEVEREUX
Stephenson Harwood
Ian has been a partner at Stephenson Harwood since 1988. He is also head of the private wealth group in Greater China. Ian has a wide range of experience of advising individuals and families in Hong Kong on a variety of issues ranging from preparing wills, advising families on complex trust structures, and philanthropic, succession and estate planning objectives.

He also has experience in all property-related transactions, including advising on acquisitions and dispositions of property (residential, commercial and industrial) in Hong Kong and China, acting for both listed and private companies in joint developments, acquisitions, sales by way of tender, public auction and private treaty, financing arrangements and leases.

He has been recognised as a ‘Leading Individual of Real Estate China (International & Hong Kong Firms)’ by Chambers Asia-Pacific from 2009 to 2018, and a ‘Leading Individual of Private Client/Wealth Management’ by Chambers High Net Worth Guide in 2017. Ian has been identified as a ‘Recommended Lawyer in Real Estate, and Tax and Trusts’ by The Legal 500 Asia Pacific in 2017. Also, Ian has been mentioned in The Legal 500 in the last few years for Real Estate, as well as for Private Client/Wealth Management in The Legal 500 Asia Pacific in 2013, 2014 and 2018, and Tax Directors Handbook in 2014 and 2018. He speaks English and Cantonese. He is a full member of STEP and a Family Firm Institute certificate holder in family business advising and family wealth advising.
PAUL DORALT  
_DORDA Rechtsanwälte GmbH_  
Paul Doralt draws on extensive experience in tax matters (corporate tax, mergers and acquisitions, and private client) and is also an expert in trusts and estates, corporate restructurings and structured finance. He is admitted to the Austrian Bar and is also a certified tax adviser. He graduated from the University of Vienna (Dr iur 1996) and from the University of London, King’s College (LLM 1997).  
Paul Doralt has been a partner at DORDA since 2006. Prior to joining the firm, he was head of the tax department at another leading, internationally active law firm in Austria. Prior to this he worked as a senior tax manager in corporate tax and was the head of the Austrian tax desk at KPMG in New York City (2001–2003) and a tax manager at KPMG in Vienna (1998–2001).

RICHARD FRIMSTON  
_Russell-Cooke LLP_  
Richard graduated in physics from Imperial College London. He is a solicitor and notary public of England and Wales. Richard was a partner and head of the private client group at Russell-Cooke LLP from 1993 to 2018 and is now a consultant.  
He contributes to Sweet & Maxwell European Cross-Border Estate Planning and the international chapters to Heywood & Massey and Jordans Court of Protection Practice, Oxford University Press International Protection of Adults and Sellier and Dalloz EU Succession Regulation and the forthcoming OUP and Dalloz commentary on the EU Rome IV Regulations.

MASAYUKI FUKUDA  
_Nagashima Ohno & Tsunematsu_  
Masayuki Fukuda is a finance law partner with Nagashima Ohno & Tsunematsu. As a specialist in trust law and finance laws, he has extensive experience and skills in structured-finance and securitisation, real-estate finance and other finance and corporate transactions, including various complicated cross-border, domestic corporate and asset finance transactions. Using his extensive knowledge and experience of trust law, security laws, investment regulations and family and inheritance laws, he currently focuses on planning and advising on optimal private wealth management structures for foreign clients as well as Japanese clients in collaboration with private bankers and other financial advisers. He has an LLM from the University of Pennsylvania (1999) and is qualified to practise in Japan and New York.

LINE-ALEXA GLOTIN  
_UGGC Avocats_  
Line-Alexa Glotin is a partner and head of the private client and tax department at UGGC Avocats in Paris. She advises private clients and institutions in a domestic and international context. She has extensive experience in assisting individuals, family businesses, family offices, charities, trustees and foundations (including art foundations), notably in regard to the transfer and restructuring of private assets, tax planning and estate planning. Ms Glotin also advises on voluntary disclosures and assists clients in tax litigation. She studied law at the
About the Authors

Panthéon-Assas University, where she received an advanced studies degree in business law and tax. She is notably a member of the International Academy of Estate and Trust Law (IAETL), STEP and the International Bar Association. She publishes regularly and is a lecturer in her field of experience abroad in private client forums.

JOEL GONZÁLEZ LOPEZ
Haynes and Boone, SC

Joel González is an associate and member of the international practice group at Haynes and Boone in Mexico City. His practice focuses on tax matters, both domestic and international, including tax planning, consulting and litigation. He has been involved in various tax strategies developed for both domestic and international corporations.

KAROLINA GOTFRYD
Sołtysiński Kawecki & Szlezak

Karolina Gotfryd graduated with a law degree with honours from Warsaw University Law School. She studied for one semester at Cologne University Law School. She took part in numerous tax law seminars and summer tax schools at Jagiellonian University in Cracow, and at Vienna University of Economics and Business. She participated in the EUCOTAX (European Universities COoperating on TAXes) Wintercourse 2016 in Vienna and her area of research was ‘SAAR - in a post BEPS world’. She is a finalist of the ‘Eye on tax’ competition 2015, organised by EY. She gained experience in legal practice at international law firms in Warsaw and London. She is a member of the International Fiscal Association (IFA).

CHRISTOPHER GROVES
Withers LLP

Christopher Groves started work at Withers in 1999 as a trainee solicitor, qualifying into the private client department in 2001, and was made a partner in 2007.

He works in the funds, investment trust and tax team of the wealth planning department and specialises in advising both UK-domiciled and non-UK-domiciled high net worth individuals in relation to their personal and business affairs.

Mr Groves’s practice includes advising individuals and trustees on UK tax issues, investment structuring for private investors and asset managers, and UK and international trust and estate planning.

EMMA HAMILTON
O’Sullivan Estate Lawyers LLP

Emma’s practice includes estate planning, estate administration and estate dispute resolution. Prior to joining O’Sullivan Estate Lawyers, Emma practiced in the areas of trusts and estates at a full service firm in Calgary. She has experience in succession and incapacity planning, estate and trust administration, estate litigation and family law matters, including domestic contracts. Emma is currently completing the STEP diploma programme and is a member of the Junior Trust and Estate Practitioners, a Toronto-based discussion forum for junior trust and estate lawyers. She is also a contributing author to various publications on estate and trust topics.
YUSHI HEGAWA
Nagashima Ohno & Tsunematsu

Yushi Hegawa is a tax partner with Nagashima Ohno & Tsunematsu. As a specialist in tax law, Mr Hegawa is fluent on all matters regarding Japanese taxation, such as tax-free reorganisations, tax-efficient mergers and acquisitions, financing and capital markets transactions, taxation of wealthy individuals, international taxation on inbound investment by foreign-owned businesses and outbound investment by Japanese businesses, and transfer pricing. He has also represented many foreign-owned taxpayers before Japanese courts and tax tribunals in controversial tax cases and has secured successful results. Mr Hegawa receives high praise from media such as Chambers Asia, Best Lawyers and The Nikkei. Mr Hegawa received his LLB from the University of Tokyo and his LLM from Harvard Law School, and is admitted to practise in Japan and New York.

KATHARINA HEMMEN
P+P Pöllath + Partners

Dr Katharina Hemmen, LLM, is admitted as attorney-at-law and tax adviser. As a counsel at P+P Pöllath + Partners in Frankfurt, she focuses on legal and tax advice with regard to domestic and international tax law, inheritance law, and succession planning, as well as trust and foundation law. She regularly speaks at conferences, such as those of the International Bar Association, on private client topics and has been ranked as ‘One to watch’ in the Private Client Global Elite 2018 by Legal Week. She has authored many publications in her practice areas.

HASAN INETAS
Marxer & Partner Rechtsanwälte

Hasan Inetas is a partner at Marxer & Partner Rechtsanwälte. He attended the University of Innsbruck, the University of Cologne and Harvard Business School. His main areas of practice include family businesses, corporate law, trust and foundation law.

HENG JIA
Lee Hishammuddin Allen & Gledhill

Heng Jia is an associate in the firm’s tax, GST and customs practice where her primary areas of practice include tax litigation, tax advisory and planning, transfer pricing and private clients. She read law at the University of Exeter and is trained as a barrister.

VALERIA KEMERER
Estudio Beccar Varela

Valeria Kemerer is a senior lawyer. She started her career at EBV in 2015. Her practice areas include company law and general business law. Valeria received her law degree from the University of Buenos Aires (1998). She represented the University of Buenos Aires in the following programmes: ‘International Business Transactions’, the Southwestern University, California and ‘International commercial arbitration moot (Vienna, Austria)’. Valeria teaches ‘Commercial and Custom Law’ at the Argentine and German Chamber of Commerce.
and Industry. She is a member of the Buenos Aires Bar Association, the International Bar Association and the Family Firm Institute.

**MARIA KILATOU**  
*Potamitis Vekris*

Maria is a tax lawyer, advising companies and individuals on tax planning and structuring, direct and indirect taxes, filing requirements and regulatory compliance. She advises on income tax, VAT and stamp duty liability for companies and individuals, as well as the taxes arising from the purchase, sale, transfer and ownership of real estate and movable assets. Maria has experience in the area of transfer pricing, as well as the application of European and international tax legislation to Greek nationals and residents. She also represents high net worth individuals on tax-related disputes and in cases of audits by the tax authorities.

**EDGAR KLEE MÜDESPACHER**  
*Haynes and Boone, SC*

Edgar Klee is a partner in the tax practice group at Haynes and Boone, and administrative partner of the firm’s Mexico City office. He focuses on offering sophisticated corporate tax advice on international taxation, tax counselling for individuals, customs and foreign trade, and general tax litigation. He has been recognised in *Latin Lawyer 250*, *Chambers Latin America* and the *Euromoney* International Tax Review as a leader in tax controversy. He is a member of the Mexican Bar, the Public Accounting Academy for Tax Studies and the International Fiscal Association.

**ELINA KOLLATOU**  
*Elias Neocleous & Co LLC*

Elina is an associate in the corporate and commercial department of Elias Neocleous & Co LLC. She graduated in law from the University of Leicester in 2008 and also holds an LLM in international commercial law and an MA in international relations and world order from the same university. Elina was admitted to the Cyprus Bar in 2012, and has since gained extensive experience in corporate law, trusts and estate planning. She also has experience in cross-border transactions including acquisitions, joint ventures, restructurings and refinancing.

**TONI ANN KRUSE**  
*McDermott Will & Emery LLP*

Toni Ann Kruse is a partner in the law firm of McDermott Will & Emery LLP and is based in the firm’s New York office. As a member of McDermott’s highly regarded private clients practice group, Toni Ann focuses her practice on all aspects of estate and wealth transfer planning. She advises clients on estate, gift and generation-skipping transfer tax issues, trust and estate administration, and charitable planning, as well as contested trust and estate matters. Her experience includes significant work with family companies, drafting and administering complex estate plans for domestic and multinational high net worth individuals and families, implementing leveraged wealth transfer techniques and counselling fiduciaries in estate administration. Toni Ann has been appointed a 2016–17 ACTEC Foundation
Young Leader. She also serves as chair of the New York office’s Pro Bono and Community Service Committee. Toni Ann received both her BA and JD from Boston College. While in law school she was the note editor for the Boston College Journal of Law and Social Justice.

ELIZABETH KUBANIK  
*Sullivan & Cromwell LLP*  
Elizabeth Kubanik is an associate in the New York office of Sullivan & Cromwell’s estates and personal group. Ms Kubanik received her JD from Vanderbilt University School of Law in 2011 and her BA from the University of Virginia in 2005. She has participated in the representation of individuals and fiduciaries in a variety of matters, including estate and trust planning and administration, the structuring of private business and investment vehicles, real estate transactions and charitable planning. Ms Kubanik is a co-author of the article entitled ‘Planning for changes of domicile, residence, citizenship, and nationality: the US Perspective’ published in the September 2012 edition of *Trusts & Trustees*.

CHRISTINE LAY KEI EEN  
*Lee Hishammuddin Allen & Gledhill*  
Christine Lay is an associate in the firm’s dispute resolution department (corporate litigation) where her primary areas of practice are commercial disputes, directors’ duties and securities litigation. She also handles probate and administration matters. She read law at the University of Liverpool.

ASHLEY LEE SI HAN  
*Lee Hishammuddin Allen & Gledhill*  
Ashley is a senior associate in the firm’s corporate practice group and her key focus is corporate and commercial transactions, for which she drafts the transactional papers from a tax and GST angle. She also works closely with colleagues from the firm’s tax, GST and customs practice when called on to advise corporate clients on matters pertaining to capital allowance, stamp duty and withholding tax. Ashley co-authored the *CCH Tax Cases Digest*, a publication that summarises and discusses various GST cases from the Commonwealth.

LAURI LEHMUSOJA  
*Hannes Snellman Attorneys Ltd*  
Lauri Lehmusoja is a counsel in the Hannes Snellman tax group. He advises clients especially in matters related to international taxation, tax litigation, tax aspects of financial instruments and incentive schemes. He is a frequent lecturer at various conferences and seminars. He is an officer in the Taxes Committee of the International Bar Association.

Prior to joining Hannes Snellman in 2011, Mr Lehmusoja was a senior tax adviser at Deloitte, and prior to that a tax specialist in the international department of the Finnish Tax Administration.
ENRIQUE LÓPEZ RIVAROLA

Estudio Beccar Varela

Enrique López Rivarola has been a lawyer at the firm since 2010. He started his career at EBV in 2008. His practice area includes tax law. Enrique received his law degree from the Universidad de Buenos Aires (2010) and obtained a specialisation in tax law from the Universidad Austral (2014). He is a member of the Buenos Aires Bar Association and the International Bar Association.

SŁAWOMIR ŁUCZAK

Sołtysiński Kawecki & Szeląg

Sławomir Łuczak graduated with a law degree from the University of Poznan. He joined SK&S in 1998 and became a partner in 2007. He previously gained experience in a recognised French audit firm. He has broad experience in international tax law and in representing clients in tax and customs matters before the tax and customs authorities and administrative courts. He also advises on tax issues in relation to restructuring projects and consolidation. He is a member of the International Fiscal Association, Association Européenne d’Etudes Juridiques et Fiscales, Union Internationale des Avocats and Regional Council of Attorneys in Warsaw.

BIRUTE LUKSENAITE

O’Sullivan Estate Lawyers LLP

Birute’s practice includes tax, estate and incapacity planning, estate administration and estate dispute resolution. Birute has extensive experience in personal and corporate taxation law and financial planning. She completed her articles at the Tax Court of Canada and subsequently practised at a national Canadian law firm and a Big Four accounting firm in Toronto and New York and worked at a major Canadian bank. Birute is currently completing the Diploma Programme of the Society of Trust and Estate Practitioners (STEP). She also serves on the Executive Committee of Ontario Bar Association’s Tax Section.

ASPASIA MALLIOU

PotamitisVekris

Aspasia has over 25 years of specialisation in advising on tax law and representing clients before the administrative courts and the Council of State. She has vast experience in advising on income, inheritance, donation and capital gains tax imposed on individuals and companies, the tax arising from a broad range of transactions and indirect taxation. Her studies in economics have afforded her a business-minded approach to the practice of law.

Aspasia has taken part in committees set up to examine tax legislation in the context of public consultations at the Ministry of the Economy and working groups at the Hellenic Federation of Enterprises for the improvement of taxation system. She is secretary of the Greek Association of Tax Law and Fiscal Studies, in which capacity she has organised and participated in numerous seminars, lectures, conferences and working groups on the interpretation of tax legislation in Greece and abroad. Aspasia has taught courses on tax law at ALBA Graduate Business School and seminars at the Athens Law Society and the Ministry of Finance on developments in the tax code. She has been widely published in newspapers and periodicals and conducts research for tax law publications. Since 2011, Aspasia has acted
as editor of the *Tax Law Bulletin*, a leading Greek publication she has contributed to as a director for the last 25 years.

**TODD D MAYO**  
*Perspecta Trust LLC*  
Todd D Mayo is a principal, general counsel and secretary of Perspecta Trust. Todd works with clients in designing and implementing trust and wealth strategies, and he oversees legal matters within the company.  

Todd is the principal author of several portions of New Hampshire’s trust laws. In addition, as a member of a public–private working group that revised the state’s banking laws, he was a principal author of the New Hampshire Trust Company Act and the New Hampshire Family Trust Company Act. He is also the principal author of the New Hampshire Foundation Act, by which New Hampshire became the first US state to allow the formation and domestication of civil law foundations.  

Todd is a member of the Society of Trusts and Estates Practitioners, a former president of the New Hampshire Trust Council and a former chair of the New Hampshire Bankers Association’s Trust Committee.  

Todd is the author of *New Hampshire Trust Laws: Statutes and Commentary* and *New Hampshire Foundation Act: Statutes and Commentary.*

**PRISCILLA MIFSUD PARKER**  
*Chetcuti Cauchi Advocates*  
Priscilla is a senior partner at Chetcuti Cauchi Advocates and she heads the corporate services department with the firm’s corporate administration arm. She mainly specialises in the use of European trusts and estate planning strategies for wealth preservation and succession planning.  

Priscilla’s practice revolves around assisting clients in the business start-up stage or with acquisitions, corporate restructurings and shareholder matters, and providing day-to-day company law and tax advice to companies under the firm’s administration.  

Priscilla has experience in advising ultra-high net worth individuals with their wealth structuring and wealth preservation strategies. Working closely with the firm’s significant international client base, she provides tailor-made, tax-efficient solutions through trusts and corporate structures set up in Malta and Cyprus. She is also heavily involved in executive relocation planning, and related legal and tax matters.

**ALAN MILGATE**  
*Rawlinson & Hunter*  
Alan is a partner at Rawlinson & Hunter in the Cayman Islands and specialises in private client services including international trust structures, private trust companies and purpose trusts, estate planning and wealth management.  

He advises on the establishment and ongoing administration of Cayman Islands trusts and companies including acting as a director of a number of private trust companies, other regulated entities and other client companies. Alan is a director of The R&H Trust Co Ltd and The Harbour Trust Co Ltd, duly licensed Cayman Islands trust companies owned and operated by Rawlinson & Hunter in the Cayman Islands.
About the Authors

Alan has over 20 years of international experience in the financial services industry and joined the Cayman practice in December 1997. Prior to moving to Cayman, his career included experience with the taxation practice of Deloitte in Canada and audit and assurance services in Canada, New Zealand and the Cayman Islands.

He is a qualified chartered accountant (Canada), trust and estate practitioner and a chartered financial analyst charter holder. He is a past-chairman of the Cayman branch of STEP (July 2015 to June 2018), a member of STEP Global Council, past-chairman of the Cayman chapter of AIMA and member of the Cayman Islands Institute of Professional Accountants.

PETER MONTEGRIFFO QC
Hassans International Law Firm

Peter’s area of expertise is in commercial and private client matters. He has also advised on numerous financial services, regulatory and trust related matters. Peter was closely involved in the IPOs of various gaming companies established in Gibraltar, which have been listed on the London Stock Exchange.

Peter has been closely involved in drafting numerous changes to Gibraltar’s legislation in trusts, financial services and gaming areas. His knowledge of these fields has led him to contribute to a large number of articles and books on Gibraltar’s legal system and financial services sector.

Peter regularly speaks at international conferences relating to these areas of practice. His work frequently requires him to deal with multiple jurisdictions as a result of which the firm has built a considerable bank of international knowledge in tax and private client arrangements.

Peter was also Gibraltar’s Minister for Trade and Industry, with responsibility for economic development and financial services, between 1996 and 2000. Having graduated from Leeds University, Peter attended the Inns of Court School of Law as a member of Lincoln’s Inn. He qualified as a barrister in 1982, becoming a partner of Hassans in 1988. Peter was appointed as Queen’s Counsel in Gibraltar in June 2014.

DP NABAN
Lee Hishammuddin Allen & Gledhill

DP Naban heads the tax, GST and customs practice at Lee Hishammuddin Allen & Gledhill together with S Saravana Kumar, a partner in the same practice group. They pioneered private client practice in Malaysia in addition to spearheading tax and customs litigation and advisory work. They have a strong track record of successfully representing taxpayers for major landmark tax appeals. A senior partner of the firm, Naban is a highly acclaimed band 1 tax lawyer (Chambers Asia). He has appeared in some of Malaysia’s most significant recent tax disputes, where clients describe him as ‘outstanding’ and recommend him for his ‘superb’ advocacy skills.
ELIAS NEOCLEOUS  
_Elias Neocleous & Co LLC_  
Elias Neocleous is managing partner of Elias Neocleous & Co LLC. He is a graduate of Oxford University and a barrister of the Inner Temple, and was admitted to the Cyprus Bar in 1993. He is a founder member of the Franchise Association of Greece, a member of the International Bar Association and the International Tax Planning Association, an honorary member of the Association of Fellows and Legal Scholars of the Center for International Legal Studies, honorary secretary of the Limassol Chamber of Commerce and Industry and serves on the committee of STEP Cyprus. His main areas of practice are banking and finance, company matters, intellectual property law, international trade, tax and trusts and estate planning, and he has many publications to his credit in the fields of corporate, taxation and trust law.

FRÉDÉRIC NEUKOMM  
_Lenz & Staehelin_  
Frédéric Neukomm is a partner and a certified tax expert in the Geneva office and a member of the private client practice group. His main areas of work are company tax law and tax law for high net worth individuals. He also works in the fields of banking and finance.

SILVIA ON  
_Stephenson Harwood_  
Silvia On is a partner in the private wealth team at Stephenson Harwood based in Hong Kong. She advises individuals and families on their succession and estate planning needs. Her experience ranges from drafting wills for individuals to setting up complex structures for families. In particular, she has helped a number of wealthy families set up trust structures to hold the family's wealth and to achieve the family's succession needs. She also has worked with and assisted family offices on a variety of matters, including helping one family set up a number of different trust structures to hold the family's diversified assets and achieve the family's philanthropic objectives. She also advises Hong Kong charities and advises on the setting up of Hong Kong charities.

She has been identified as an Associate to Watch by _Chambers Asia-Pacific_ (now _Chambers Global High Net Worth Guide_) for Private Client/Wealth Management (International Firms) from 2013 to 2017, and Up and Coming in 2018. Also, from 2013 to 2017, she was listed in the _Citywealth_ Leaders List. Silvia was also featured in ‘The IFC Power Women Top 200’ by _Citywealth_ from 2014 to 2017. Silvia was named as a Rising Star in the Spears Asia Index and Forty under Forty 2016 by _Asia Legal Business_. Silvia has also been listed in _Who’s Who Legal: Private Client_ in 2016 and 2017. Silvia contributed the article ‘Considering a Trust in Pre-IPO Planning’ in the _IPO Handbook for Hong Kong 2015_ and contributed the article ‘Trusts are not bullet proof armour’ in _The Journal of International Tax, Trust and Corporate Planning_. Silvia was also invited to teach at the CEIBS Family Office Diploma Programme 2016 and 2017. She is also a fellow of the Association of Certified Chartered Accountants and an executive committee member of STEP’s Hong Kong branch.
MARGARET R O’SULLIVAN
O’Sullivan Estate Lawyers LLP
Margaret O’Sullivan exclusively practises estate planning, estate litigation, advising executors, trustees and beneficiaries, and administration of trusts and estates. Prior to establishing an independent trusts and estates boutique firm, she was a partner at Stikeman Elliott, where she directed its trusts and estates practice. She is a past deputy chair and member of the board of directors and council for the STEP Worldwide; past chair of the professional standards committee of STEP Worldwide; past member of the management and finance committee; past deputy chair of STEP (Canada); past chair of the editorial board for STEP Inside; past chair of the Trusts and Estates Law section, Ontario Bar Association; elected fellow, ACTEC, 1995; and academician of The International Academy of Estate and Trust Law. She received the 2014 STEP Founder’s Award for Outstanding Achievement and the Ontario Bar Association’s 2013 Award of Excellence in Trusts and Estates Law.

She has written two textbooks for the Trust Institute of the Institute of Canadian Bankers: *Engineering of a Trust* and *Trust and Estate Management*. She is also author of the Canada chapter of *International Succession Laws* (Tottel, 2009) and contributing author to *Widdifield on Executors and Trustees* (Carswell, 2002), *Key Developments in Estates and Trusts Law in Ontario* (Canada Law Book, 2008) and to *The International Comparative Legal Guide to: Private Client 2018* (Global Legal Group 2018). She was called to the Ontario Bar in 1983.

JANOS PASZTOR
Wolf Theiss
Janos Pasztor is a senior associate heading the tax practice group at Wolf Theiss Budapest. He completed his studies at the Faculty of Law of Eötvös Loránd University and has an LLM degree in international taxation (WU Vienna). He is also a qualified and chartered tax adviser in Hungary. Prior to joining Faludi Wolf Theiss in 2014, Janos worked at Ernst & Young Hungary as a tax manager and attorney-at-law. Janos specialises in domestic and international tax planning, tax restructuring and also provides comprehensive tax and legal advisory for high net worth individuals. He regularly represents clients in tax litigation proceedings relating to all major types of tax. Janos also frequently presents at domestic and international events on cross-border taxation, tax litigation and tax restructuring, as well as providing lectures on tax matters. Janos speaks fluent English and German.

JOSÉ PEDROSO DE MELO
SRS Advogados
José Pedroso de Melo is a specialised tax lawyer with solid experience in this area, advising in domestic and international tax law, banking and insurance, corporate and high net worth individuals’ assets restructuring, mergers and acquisitions operations, compliance procedures and tax litigation.

He began his career in the international audit firm Mazars Portugal, as tax manager, and later joined the tax departments of Garrigues and PLMJ, two of the major law firms in Portugal. He is currently managing associate of the tax department at SRS Advogados.

Recognised as a tax expert by the Portuguese Bar Association, where he is inscribed since 1998, he is a member of the Portuguese Fiscal Association. He is recommended as a tax
lawyer by the international legal directories The Legal 500 and Chambers and Partners. He is also a tax arbitrator at the Centre of Administrative Arbitration.

A speaker at several conferences on tax law, he is frequently invited to publish opinion articles regarding tax issues in economic newspapers and is a regular commentator on a specialised TV channel.

SIMONE RETTER
Retter Attoners SÀRL

Simone Retter has been a member of the Luxembourg Bar since 1985.

For more than three decades, Simone Retter has been advising high net worth families and entrepreneurs on the legal structuring of their wealth and investments. Her areas of expertise reach from corporate and civil law to estate planning matters.

In 2009, she founded Retter Attorneys, a boutique law firm exclusively dedicated to private clients. Simone Retter concentrates her activity on a short list of ultra-high net worth families for which she provides legal and family office services and assists them in their global wealth structuring and estate planning. Simone Retter holds a master's degree in law from the University of Paris (Panthéon-Sorbonne) and is a graduate from the Paris Institute of Political Studies (Sciences-Po) – Economic and Finance Section. She attended successfully the Executive Program for Overseas Bankers at Wharton Business School, University of Pennsylvania (US). She lectured in commercial law and in the wealth management master programme at the University of Luxembourg.

She is a member of STEP.

JOHN RICHES
RMW Law LLP

John works with prominent international family offices on a cross-border basis and deals with structuring for UK residents and resident non-domiciled families. He creates structures for active entrepreneurs to hold business interests and advises on issues relating to the interaction of family and business governance. John is frequently listed in many publications as a leading private client adviser to international families, and has won many awards for his work, most recently the Spears Tax and Trust Lawyer of the Year Award 2017.

John has a deep interest in tax and regulatory policy and represents the profession in these matters. He has held a variety of senior posts in STEP and is currently co-chair of its public policy committee. In this role, John has been responsible for liaising with national and supra national bodies on matters of tax policy affecting wealthy families, and has been consulted by the Organisation for Economic Co-operation and Development in respect of its initiative for high net worth individuals; he also attended a number of sessions of the Financial Action Task Force Consultative Forum, which seeks views from the private sector on its proposals and guidance to Member States. John co-authored the STEP practice note on the Common Reporting Standard and trusts.

He has also been involved with the International Academy of Trust and Estate Lawyers, becoming an academician by invitation in 2007 and elected as vice-president for Europe in May 2014; the American College of Trust and Estate Council since 2011, when he was invited to become an international fellow in recognition of his significant cross-border practice; and the Institute for Family Business, where for many years John has been a member of the advisory council in the UK, providing input on a wide range of legal and tax policy matters.
ANDREAS RICHTER

P+P Pöllath + Partners

Dr Andreas Richter, LLM, is a partner and a member of the management board at P+P Pöllath + Partners. He has outstanding experience in business and wealth succession, estate planning, legal and tax structuring of private wealth and family offices, corporate governance for family-owned businesses, expatriation taxation and charities, as well as in trust and foundation law. Some of Germany’s leading family offices, family businesses and foundations, as well as their peers abroad, form the client base for Andreas’s work as a legal and tax adviser. Clients in common law jurisdictions often engage Andreas owing to his background in English law (BA Hons, Trinity College, Cambridge) and US law (LLM, Yale Law School). He is listed in domestic and international rankings as one of the leading lawyers in his practice areas. Among others, Who’s Who Legal: Thought Leaders 2018 lists Andreas Richter as the only German lawyer among the 15 ‘Most Highly Regarded Individuals’ worldwide in the practice area ‘Private Client’.

Andreas is the managing director of the Berlin Tax Policy Forum, chairman of the executive board of the postgraduate programme ‘Inheritance Law & Business Succession’ at the University of Munster and is a member of the International Academy of Estate and Trust Law. He serves as a member on boards of family offices, foundations and family businesses and acts as executor.

Andreas is the editor of the leading German compendium on foundations and trusts and related tax issues. He also is the author and editor of numerous other publications, commentaries and compendiums, in particular on family offices, foundation law, business succession and all tax-related matters.

HEINI RÜDISÜHLI

Lenz & Staehelin

Heini Rüdisühli is a partner in the Zurich office, where he leads the private client practice group. His main field of activity is national and international tax planning for private individuals as well as taxation of corporate reorganisations and acquisitions. In addition, Heini Rüdisühli specialises in inheritance law and succession planning as well as executorship of estates. He has a broad knowledge of trusts.

NICOLA SACCARDO

Maisto e Associati

Nicola is a partner of Maisto e Associati and is based in the London office of the firm. He obtained a degree in business administration from the Bocconi University in Milan and a degree in law from the Italian State University, as well as a master of laws (LLM) in international taxation from the University of Leiden (The Netherlands). He is admitted to the Italian Bar and the Italian Association of Chartered Accountants, is a member of the International Academy of Estate and Trust Law, as well as its vice president and chair of its Tax Committee. He is a member of STEP, of the International Client London UK Satellite SIG Committee of STEP as well as of the International Client Global SIG Steering Committee of STEP. He is ranked as leading expert in several legal directories, including Chambers High Net Worth 2017, Legal Week Private Clients Global Elite and Citywealth Leaders List. He is author of many publications on Italian tax matters and is frequent speaker
at conferences. His areas of expertise include taxation of trusts, estates, and high net worth individuals and estate planning.

CHRISTOPHER SALOMONS

*Russell-Cooke LLP*

Christopher is half Dutch and has an MA in Classics from Keble College, Oxford. He is a solicitor of England and Wales and has been with Russell-Cooke LLP since 2013 where he is a senior associate.

Christopher’s area of specialism is in cross-border succession matters. He has previously worked in Guernsey and Geneva.

CLAUDIA SHAN

*Cone Marshall Limited*

Claudia Shan graduated from the University of Auckland, New Zealand with a BCom/LLB conjoint degree. She has been in legal practice since 2004. She has also worked for two leading offshore law firms in the Channel Islands and was at the time enrolled and admitted to practise as a solicitor of the Supreme Court of England and Wales. Prior to entering practice in a leading New Zealand law firm, she worked in the Auckland office of a global chartered accountancy firm focusing on tax. Claudia specialises in all aspects of trust, private client and international wealth planning. Claudia has advised a wide range of clients, both residents and non-residents, on local and foreign trusts, offshore fund repatriation, tax residency, asset protection, FATCA, Common Reporting Standard, international compliance, tax and trust law issues. She is a member of STEP.

SM SHANMUGAM

*Lee Hishammuddin Allen & Gledhill*

SM Shanmugam is a partner in the dispute resolution department (corporate litigation). As a litigator, Shan has notable experience in advising and acting as counsel in cases involving breach of directors’ duties, securities litigation involving market misconduct and insider trading, shareholders’ dispute and negligence lawsuits. He also has experience in commercial arbitration. Shan has acted and defended regulators, private companies, public listed companies and government agencies and appears frequently before the High Court and appellate courts. He is also experienced in representing private clients for contentious and non-contentious probate and administration matters.

MICHAEL D SHAPIRO

*McDermott Will & Emery LLP*

Michael D Shapiro is an associate in the private clients practice group in the New York office of the law firm of McDermott Will & Emery LLP. Michael's practice focuses on sophisticated estate, wealth, tax, and charitable planning for domestic and international families and individuals. His practice also includes advising on trust and estate administration and contested trust and fiduciary matters. Michael is a graduate *summa cum laude* of Loyola Law School, Los Angeles, where he was a senior production editor of the *Loyola of Los Angeles International and Comparative Law Review*. Michael also holds an LLM in taxation from New York University.
MIGUEL MARÍA SILVEYRA  
*Estudio Beccar Varela*  
Miguel María Silveyra started his career at EBV in 1998 and has been a partner of the firm since 2009. He specialises in family business governance and family estate planning. He has advised several families in the process of negotiation, planning and designing of their corporate governance rules, in drafting their family protocols and shareholders’ agreements, and in planning their estate and business succession. Miguel received his law degree from the Universidad Católica Argentina (1993) and obtained his LLM from the Universidad Austral (Buenos Aires, Argentina, 1995) and his Diploma in Advanced Studies from the Universidad Autónoma de Madrid (Madrid, Spain, 2004). He worked as a foreign associate at Gomez Acebo & Pombo (Madrid, Spain, 2004). He is a member of the Buenos Aires Bar Association, the International Bar Association and the Family Firm Institute.

SUSAN SONG  
*Sullivan & Cromwell LLP*  

STEFAN STELLATO  
*Hannes Snellman Attorneys Ltd*  
Stefan Stellato is an associate in the Hannes Snellman tax group. Prior to graduation from the University of Helsinki, he spent a semester studying at a university in New York. Besides his master of laws degree, he holds a master of science (economics and business administration) degree from Hanken School of Economics in Helsinki.

MARKUS SUMMER  
*Marxer & Partner Rechtsanwälte*  
Markus Summer is a partner at Marxer & Partner Rechtsanwälte, Liechtenstein’s oldest and largest law firm. He has obtained legal degrees from the University of Innsbruck, King’s College London and the University of Texas at Austin, and an MBA from Edinburgh Business School. His areas of special interest include tax law, trust and foundations, corporate law, finance law and investments. He is a member of the STEP and of the International Fiscal Association.
SILVANIA TOGNETTI  
*Tognetti Advocacia*

Tognetti Law’s main partner, Silvania Tognetti is both a national and international expert in tax law, and is regarded for her versatility, deep understanding within various legal areas, and creativity. These features can be seen by the diversity of clients and the successful projects carried out throughout her career, which includes the public sector (the State Attorney of Rio de Janeiro, Representative of the Federal Revenue before the Board of Contributors of Rio de Janeiro and Secretary of Finance of Rio de Janeiro), enterprises (investment banks, international tax consultancy), and law firms (attorney in corporate reorganisation, mergers and acquisitions, administrative and judicial tax litigation, and succession planning). Since 2006, Mrs Tognetti has been recommended as a tax lawyer by *Chambers Global*. She attended the Federal University of Rio de Janeiro (JD, 1993), the graduate programme (1994) and holds a master’s degree (2001) from Universidade Cândido Mendes in Rio de Janeiro. She also has a PhD from the University of São Paulo (2009). Her professional memberships include ABDF, IFA, IBA, ABA, IBDT and the Chambers of Commerce of Brazil–Italy and Brazil–Portugal.

JOHN F WILSON  
*McKinney Bancroft & Hughes*

John Fitzgerald Wilson is a commercial litigation attorney whose areas of expertise include Admiralty litigation, trust litigation, and fraud recovery involving the tracing and recovery of stolen assets. In addition to his litigation work, Mr Wilson advises several of the larger Bahamian trust companies and is actively engaged in the firm’s work in the private client area, advising high net worth individuals on the use of various offshore products.

Following his education at the University of Buckingham in England, he was admitted to the Bar of England and Wales and the Bahamas Bar in 1994. He was also admitted to the Honourable Society of Lincoln’s Inn of the United Kingdom. Mr Wilson was admitted to partnership in the firm in 2001. He was the first Bahamian to appear as lead counsel during the Privy Council’s historic first sitting in the Bahamas, and he was commended by the Law Lords for the skill with which he presented his client’s case. In February 2016, Mr Wilson was the sole winner of the Client Choice Award in the Bahamas in the area of litigation.

Mr Wilson is the contributing editor for the Bahamas chapter of the English version of the *International Real Estate Handbook* published by John Wiley & Sons, a publication directed to high net worth Europeans and their professional advisers, a contributing editor to Carter-Ruck on *Libel and Privacy* and a contributing editor to *ADR and Trusts*. Mr Wilson regularly writes articles and delivers speeches in his field.
BASIL ZIRINIS

_Sullivan & Cromwell LLP_

Basil Zirinis has been a partner in Sullivan & Cromwell’s estates and personal group since 1994 and leads its international private client practice from London and New York. He represents individuals, fiduciaries and family-controlled businesses throughout the world in a broad range of matters, including estate and trust planning, family business governance and transition, estate and trust administration and litigation. Mr Zirinis has extensive experience in trust and estate litigation and has been involved in many of the leading litigations in this area in the past 25 years in the United States and abroad. He speaks regularly at international conferences regarding US and international tax and estate planning, including most recently in Shanghai, London, Lake Como, Bermuda, New York and Istanbul.
Appendix 2

CONTRIBUING LAW FIRMS’ CONTACT DETAILS

ALARCÓN ESPINOSA ABOGADOS

c/ Fernando el Santo 25, 4º Drcha
28010 Madrid
Spain
Tel: +34 91 129 49 69
palarcon@alarcon-espinosa.com
www.alarcon-espinosa.com

CHETCUTI CAUCHI ADVOCATES

120 St Ursula Street
Valletta VLT 1236
Malta
Tel: +356 22 05 6105 / 6121
Fax: +356 22 05 6201
askjpc@cclex.com
askpmp@cclex.com
www.cclex.com

CHRISTIE’S

8 King Street, St James’s
London
SW1Y 6QT
United Kingdom
Tel: +44 20 7839 9060
Fax: +44 20 7389 2300
rcornett@christies.com
www.christies.com

CONE MARSHALL LIMITED

Level 3
18 Stanley Street
Auckland 1010
New Zealand

PO Box 137069
Parnell
Auckland 1151
New Zealand

Tel: +64 9 307 3950
Fax: +64 9 366 1482
gcone@conemarshall.com
cshan@conemarshall.com
www.conemarshall.com

CONYERS DILL & PEARMAN

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

PO Box 666
Hamilton HM CX
Bermuda

Tel: +1 441 295 1422
Fax: +1 441 292 4720
alec.anderson@conyersdill.com
stephanie.bernard@conyersdill.com
www.conyersdill.com
Contributing Law Firms’ Contact Details

DORDA RECHTSANWÄLTE GMBH
Universitätsring 10
1010 Vienna
Austria
Tel: +43 1 533 4795 101
Fax: +43 1 533 4795 50101
paul.doralt@dorda.at
katharina.binder@dorda.at
www.dorda.at

ELIAS NEOCLEOUS & CO LLC
Neocleous House
195 Makarios III Avenue
PO Box 50613
3608 Limassol
Cyprus
Tel: +357 25 110 110
Fax: +357 25 110 001
elias.neocleous@neo.law
elina.kollarou@neo.law
info@neo.law
www.neo.law

ESTUDIO BECCAR VARELA
Tucumán 1, Third Floor
Buenos Aires
Argentina
Tel: +54 11 4379 6800
Fax: +54 11 4379 6869
msilveyra@ebv.com.ar
vkemerer@ebv.com.ar
elopez@ebv.com.ar
www.ebv.com.ar

FB-PRIVATE WEALTH LAW
Opaallaan – Avenue de l’Opale 115/b6
1030 Brussels
Belgium
Tel: +32 2 309 73 66
Fax: +32 2 309 73 99
ferenc@advocaatballegeer.be
www.advocaatballegeer.be

FIRST NAMES GROUP
First Names House
Victoria Road
Douglas
IM2 4DF
Isle of Man
Tel: +44 1624 630 630
Fax: +44 1624 624 469
craig.brown@firstnames.com
www.firstnames.com

HANNES SNELLMAN ATTORNEYS LTD
Eteläesplanadi 20
00130 Helsinki
Finland
Tel: +358 9 228 841
Fax: +358 9 177 393
lauri.lehmusoja@hannessnellman.com
stefan.stellato@hannessnellman.com
www.hannessnellman.com

HASSANS INTERNATIONAL LAW FIRM
57/63 Line Wall Road
Gibraltar GX11 1AA
Tel: +350 200 79000
Fax: +350 200 71966
peter.montegriffo@hassans.gi
www.gibraltarlaw.com

HAYNES AND BOONE, SC
Torre Esmeralda I, Blvd
Manuel Ávila Camacho #40
Despacho 1601
Col Lomas de Chapultepec
11000, Mexico City
Mexico
Tel: +52 55 5249 1800
Fax: +52 55 5249 1801
edgar.klee@haynesboone.com
joel.gonzalez@haynesboone.com
www.haynesboone.com

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LEE HISHAMMUDDIN ALLEN & GLEDHILL
Level 6, Menara 1 Dutamas
Solaris Dutamas
No. 1 Jalan Dutamas 1
50480 Kuala Lumpur
Malaysia
Tel: +603 6208 5888
Fax: +603 6201 0122
tax@lh-ag.com
www.lh-ag.com

LENZ & STAHELIN
30 route de Chêne
PO Box 6165
1211 Geneva 6
Switzerland
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01
mark.barmes@lenzstaehelin.com
frederic.neukomm@lenzstaehelin.com
heini.ruedisuehli@lenzstaehelin.com

24 Brandschenkestrasse
8027 Zurich
Switzerland
Tel: +41 58 450 80 00
Fax: +41 58 450 80 01

58 avenue de Rhodanie
1007 Lausanne
Switzerland
Tel: +41 58 450 70 00
Fax: +41 58 450 70 01
www.lenzstaehelin.com

MAISTO E ASSOCIATI
Piazza Filippo Meda 5
20121 Milan
Italy
Tel: +39 0277 6931
Fax: +39 0277 6933 00

Piazza D’Aracoeli 1
00186 Rome
Italy
Tel: +39 06 4544 1410
Fax: +39 06 4544 1411

2 Throgmorton Avenue
London
EC2N 2DG
United Kingdom
Tel: +44 20 7374 0299
Fax: +44 20 7374 0129
n.saccardo@maisto.it
www.maisto.it

MARXER & PARTNER RECHTSANWÄLTE
Heiligkreuz 6
PO Box 484
9490 Vaduz
Liechtenstein
Tel: +423 235 81 81
Fax: +423 235 82 82
markus.summer@marxerpartner.com
hasan.inetas@marxerpartner.com
www.marxerpartner.com

MCDERMOTT WILL & EMERY LLP
340 Madison Avenue
New York, NY 10173-1922
United States
Tel: +1 212 547 5400
Fax: +1 212 547 5444
tkruse@mwe.com
mdshapiro@mwe.com
www.mwe.com
<table>
<thead>
<tr>
<th>Contributing Law Firms’ Contact Details</th>
</tr>
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<tbody>
<tr>
<td><strong>MCKINNEY BANCROFT &amp; HUGHES</strong></td>
</tr>
<tr>
<td>Mareva House</td>
</tr>
<tr>
<td>4 George Street</td>
</tr>
<tr>
<td>Nassau</td>
</tr>
<tr>
<td>The Bahamas</td>
</tr>
<tr>
<td>Tel: +1 242 322 4195</td>
</tr>
<tr>
<td>Fax: +1 242 328 2520</td>
</tr>
<tr>
<td><a href="mailto:jfwilson@mckinney.com.bs">jfwilson@mckinney.com.bs</a></td>
</tr>
<tr>
<td><a href="http://www.mckinney.com.bs">www.mckinney.com.bs</a></td>
</tr>
<tr>
<td><strong>NAGASHIMA OHNO &amp; TSUNEMATSU</strong></td>
</tr>
<tr>
<td>JP Tower, 2-7-2 Marunouchi</td>
</tr>
<tr>
<td>Chiyoda-ku</td>
</tr>
<tr>
<td>Tokyo 100-7036</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>Tel: +81 3 6889 7000</td>
</tr>
<tr>
<td>Fax: +81 3 6889 8000</td>
</tr>
<tr>
<td><a href="mailto:yushi_hegawa@noandt.com">yushi_hegawa@noandt.com</a></td>
</tr>
<tr>
<td><a href="mailto:masayuki_fukuda@noandt.com">masayuki_fukuda@noandt.com</a></td>
</tr>
<tr>
<td><strong>NERINE TRUST COMPANY LIMITED</strong></td>
</tr>
<tr>
<td>Nerine House, St George’s Place</td>
</tr>
<tr>
<td>St Peter Port GY1 3ZG</td>
</tr>
<tr>
<td>Guernsey</td>
</tr>
<tr>
<td>Tel: +44 1481 701 300</td>
</tr>
<tr>
<td>Fax: +44 1481 711 224</td>
</tr>
<tr>
<td><a href="mailto:keith.corbin@nerine.com">keith.corbin@nerine.com</a></td>
</tr>
<tr>
<td><a href="mailto:mark.biddlecombe@nerine.com">mark.biddlecombe@nerine.com</a></td>
</tr>
<tr>
<td><a href="http://www.nerine.com">www.nerine.com</a></td>
</tr>
<tr>
<td><strong>NAGASHIMA OHNO &amp; TSUNEMATSU</strong></td>
</tr>
<tr>
<td>JP Tower, 2-7-2 Marunouchi</td>
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<tr>
<td>Chiyoda-ku</td>
</tr>
<tr>
<td>Tokyo 100-7036</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>Tel: +81 3 6889 7000</td>
</tr>
<tr>
<td>Fax: +81 3 6889 8000</td>
</tr>
<tr>
<td><a href="mailto:yushi_hegawa@noandt.com">yushi_hegawa@noandt.com</a></td>
</tr>
<tr>
<td><a href="mailto:masayuki_fukuda@noandt.com">masayuki_fukuda@noandt.com</a></td>
</tr>
<tr>
<td><strong>PERSPECTA TRUST LLC</strong></td>
</tr>
<tr>
<td>One Liberty Lane East, Suite 100</td>
</tr>
<tr>
<td>Hampton, NH 03842</td>
</tr>
<tr>
<td>United States</td>
</tr>
<tr>
<td>Tel: +1 603 929 2671</td>
</tr>
<tr>
<td><a href="mailto:tmayo@perspectatrust.com">tmayo@perspectatrust.com</a></td>
</tr>
<tr>
<td><a href="http://www.perspectatrust.com">www.perspectatrust.com</a></td>
</tr>
<tr>
<td><strong>POTAMITIS VEKIRIS</strong></td>
</tr>
<tr>
<td>9 Neofytou Vamva str.</td>
</tr>
<tr>
<td>10674 Athens</td>
</tr>
<tr>
<td>Greece</td>
</tr>
<tr>
<td>Tel: +30 210 338 0000</td>
</tr>
<tr>
<td>Fax: +30 210 338 0020</td>
</tr>
<tr>
<td><a href="mailto:aspasia.malliou@potamitisvekris.com">aspasia.malliou@potamitisvekris.com</a></td>
</tr>
<tr>
<td><a href="mailto:maria.kilatou@potamitisvekris.com">maria.kilatou@potamitisvekris.com</a></td>
</tr>
<tr>
<td><a href="http://www.potamitisvekris.com">www.potamitisvekris.com</a></td>
</tr>
<tr>
<td><strong>P+P PÖLLATH + PARTNERS</strong></td>
</tr>
<tr>
<td>Potsdamer Platz 5</td>
</tr>
<tr>
<td>10785 Berlin</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Tel: +49 30 25353 132</td>
</tr>
<tr>
<td>Fax: +49 30 25353 999</td>
</tr>
<tr>
<td><a href="mailto:andreas.richter@pplaw.com">andreas.richter@pplaw.com</a></td>
</tr>
</tbody>
</table>

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Contributing Law Firms’ Contact Details

An der Welle 3
60322 Frankfurt
Germany
Tel: +49 69 247047 83
Fax: +49 69 247047 30
katharina.hemmen@pplaw.com
www.pplaw.com

RAWLINSON & HUNTER
2nd floor, Windward 1
Regatta Office Park
Grand Cayman KY1-1103
Cayman Islands
Tel: +1 345 949 7576
Fax: +1 345 949 8295
alan.milgate@rawlinson-hunter.com.ky
www.rawlinson-hunter.com

RECABARREN & ASOCIADOS
Alcantara 107
Las Condes
Santiago
Chile
Tel: +56 2 2594 0550
Fax: +56 2 2207 6881
pablo.chechilnitzky@recabarrenasociados.com
www.recabarrenasociados.com

RETTER ATTORNEYS SÀRL
14 avenue du X Septembre
L-2550 Luxembourg
Tel: +352 27 99 01 03
Fax: +352 27 99 01 039
simone.rett@rettieravocats.lu
www.rettier.lu

RMW LAW LLP
20 Old Bailey
London
EC4M 7AN
United Kingdom
Tel: +44 20 7100 5120
Fax: +44 207 597 6543
john@rmwlaw.co.uk
www.rmwlaw.co.uk

RUSSELL-COOKE LLP
2 Putney Hill
London
SW15 6AB
United Kingdom
Tel: +44 20 8789 9111
Fax: +44 20 8788 6552
helpdesk@russell-cooke.co.uk
richard.frimston@russell-cooke.co.uk
christopher.salomons@russell-cooke.co.uk
www.russell-cooke.co.uk

SOŁTYSIŃSKI KAWECKI & SZLĘZAK
26 Jasna Street
00-054 Warsaw
Poland
Tel: +48 22 608 70 56 / 71 75
Fax: +48 22 608 70 70
slawomir.luczak@skslegal.pl
karolina.gotfryd@skslegal.pl
www.skslegal.pl

SRS ADVOGADOS
Rua Dom Francisco Manuel de Melo, 21
1070-085 Lisbon
Portugal
Tel: +351 21 313 20 00
Fax: +351 21 313 20 01
jose.melo@srlegal.pt
www.srlegal.pt
STEP
Artillery House (South)
11-19 Artillery Row
London
SW1P 1RT
United Kingdom
Tel: +44 20 3752 3763
emily.deane@step.org
www.step.org

STEPHENSON HARWOOD
18th floor, United Centre
95 Queensway
Hong Kong
Tel: +852 2868 0789
Fax: +852 2868 1504
ian.devereux@shlegal.com
silvia.on@shlegal.com
www.shlegal.com

SULLIVAN & CROMWELL LLP
125 Broad Street
New York, NY 10004-2498
United States
Tel: +1 212 558 4000
Fax: +1 212 558 3588
1 New Fetter Lane
London
EC4A 1AN
United Kingdom
Tel: +44 20 7959 8900
Fax: +44 20 7959 8950
zirinisb@sullcrom.com
demamielk@sullcrom.com
kubanike@sullcrom.com
songs@sullcrom.com
www.sullcrom.com

TOGNETTI ADVOCACIA
Rua do Rocio, 288
cj 44 Vila Olimpia
São Paulo 04552-000
Brazil
Tel: +55 11 3045 3131
silvania.tognetti@tognetti.com.br
www.tognetti.com.br

UGGC AVOCATS
47 rue de Monceau
75008 Paris
France
Tel: +33 1 56 69 70 00
Fax: +33 1 56 69 70 71
la.glotin@uggc.com
www.uggc.com

WITHERS LLP
20 Old Bailey
London
EC4M 7AN
United Kingdom
Tel: +44 20 7597 6000
Fax: +44 20 7597 6543
christopher.groves@withersworldwide.com
www.withersworldwide.com

WOLF THEISS
Kálvin tér 12–13
Kálvin Square 4th floor
1085 Budapest
Hungary
Tel: +36 1 4848 800
Fax: +36 1 4848 825
pasztor.janos@wolftheiss.com
www.wolftheiss.com
For more information, please contact info@thelawreviews.co.uk

THE ACQUISITION AND LEVERAGED FINANCE REVIEW
Christopher Kandel
Latham & Watkins LLP

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Mark F Mendelsohn
Paul, Weiss, Rifkind, Wharton & Garrison LLP

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Paul Dickson
Slaughter and May

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Richard Swallow
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