THE PRIVATE WEALTH & PRIVATE CLIENT REVIEW

SEVENTH EDITION

Editor
John Riches

THE LAWREVIEWS

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CONTENTS

PREFACE

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.

i 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.*[1]

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.*[2]

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.*[3]

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.*[4]

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.

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

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:

a the amendment of the trust instrument;

b the addition or removal of any beneficiary, or any person from a class of beneficiaries, or any action affecting the entitlement of a beneficiary;

c the appointment or removal of trustees or protectors or to give another individual control over the trust;

d the acceptance of an additional settlor as may be applicable in terms of the terms of the trust instrument;

e the change of the proper law of the trust; and

f 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:

a by committees where, to date, it has been argued that no one individual can personally decide upon a course of action;

b 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

c by those with negative 'veto' powers but without positive powers to decide upon specific matters that impact the relevant trust.

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

Chapter 28

LUXEMBOURG

Simone Retter[1]

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.

1 Simone Retter is a partner at Retter Attorneys.

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.

Luxembourg has not signed any international treaty on estate law and estate taxation, except for the Hague Convention of 5 October 1961, modified in 1978 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions (Hague Testamentary Dispositions Convention), and the Basel Convention on the Establishment of a Scheme of Registration of Wills concluded on 6 May 1972, modified in 1978.

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:

a gifts made by the deceased in the year preceding the death, unless gift tax has been paid;
b other assets received by a third party without tax pursuant to a contractual arrangement (e.g., life insurance); and
c 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:

a zero per cent on the forced heirship entitlement of those in the direct bloodline;
b zero per cent on property transferred between spouses and partners bound by a partnership agreement registered for more than three years;
c 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);
d 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));
e 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);
f 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
g 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:

a 10 per cent for estates with a value between €10,000 and €20,000; and
b 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:

a 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;
b 4.8 per cent on gifts between spouses and partners bound by a partnership agreement registered for more than three years;
c 6 per cent on gifts between siblings;
d 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);
e 8.4 per cent on gifts between uncles and aunts, and nephews and nieces;
f 9.6 per cent on gifts between great-uncles and great-aunts, and great-nephews and great-nieces; and
g 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:

a 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;
b 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
c 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:

a the descendant (legitimate, natural, adopted);
b the surviving spouse;
c privileged ascendants and collaterals (father, mother, brother, sister and their descendants);
d ascendants other than mother and father;
e other collaterals; and
f 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 joints 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 on their Recognition 1985 (Hague Trusts Convention) (Law of 27 July 2003). Luxembourg 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 compliancy. 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.

Appendix 1

ABOUT THE AUTHORS

SIMONE RETTER

Retter Attonerys 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.

RETTER ATTORNEYS SÀRL

14 avenue du X Septembre
L-2550 Luxembourg
Tel: +352 27 99 01 03
Fax: +352 27 99 01 039
simone.retter@retteravocats.lu
www.retter.lu

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