

Draft bill regarding the Luxembourg private foundation

August 2013

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Why a Luxembourg private foundation?

As the largest private banking centre within the EU, Luxembourg has gained many years' expertise in asset management. Similar to France, but in contrast to many other continental European and English-speaking countries ("trusts"), the Luxembourg Civil Code (strongly influenced by the Code Napoléon) does not contain any regulations for foundations. Although the present legal structures for asset management in Luxembourg provide it with a competitive advantage compared with other financial centres, the lack of foundations enabling asset management oriented towards companies and families with cross-border ambitions/relationships is increasingly regarded as a handicap.

The complete absence of such a legal structure now provides an opportunity to create an entirely modern, European-oriented private foundation.

abundantly clear that a foundation must not interfere with the management of any companies in which it invests. Nevertheless, as an asset management tool, the foundation enables its founder to secure and manage various interests for their future heirs during their lifetime. For example, interests in the management (voting rights) and financial interests (dividends) of companies invested in by the foundation can be separated from one another by means of securitisation.

However, contributions made to the foundations are certainly not limited to an entire company. The European-oriented legislation makes it possible to include all possible assets in the foundation, including real estate from various European countries (e.g. the assets of a family resident in several EU countries) and manage these "bundled" assets as effectively as possible.

Integrated asset management

The trend in asset management is towards comprehensive support of private customers through all the stages of their lives, with all the highs and lows, right through to succession planning. It is frequently argued that the main advantage of a foundation is that it gives company founders or entrepreneurs the opportunity to ensure the continued existence of their company even after their death. This is also one of the primary objectives of the Luxembourg private foundation. However, the Luxembourg draft bill makes it

The triangle: asset protection, money laundering standards and confidentiality

The objective of protecting a foundation/company against a "hostile takeover" or forced break-up is achieved by ensuring that, although the private foundation has a legal personality (and is thus fully subject to Luxembourg law, amongst others), it has no shareholders ("orphan" structure). The lack of shareholders is compensated for by the fact that the Board of Directors will assume special and increased responsibility. In order

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Income tax treatment

to protect the interests of the founder and all parties involved, the corporate governance of the foundation, including the civil and criminal liability of the members of the Board of Directors, shall be subject to very detailed regulation. Detailed regulations have also been made just in case the entire Board of Directors of a foundation resigns, a situation that would leave the foundation “without a helmsman”, so to speak, and cause problems in many countries.

In accordance with one of the options provided in the latest Financial Action Task Force money laundering standards, the Board of Directors of the foundation is obliged to make available all documents necessary for identifying the founder and other related parties at the foundation’s registered office and to keep these documents up to date. The Board of Directors shall be criminally liable in case of non-respect of these obligations. In contrast to the company register option, this approach offers the opportunity to combine the confidentiality for which Luxembourg is known with the strictest adherence to the standards.

Establishment and contribution

The foundation shall be established before a notary. The value of the initial contribution must be at least EUR 50,000. There is no lower limit on subsequent contributions. There is no (gift) tax on contributions in Luxembourg, only a fee (“droit fixe”) is to be paid. The asset (the company, real estate) shall be revalued (step up in basis). If the contribution is made from abroad, this usually does not have any tax consequences in Luxembourg.

As a Luxembourg private foundation has a legal personality, it is a corporation. In principle, it is therefore subject to corporation tax. However, the foundation also temporarily (i.e. until distribution to beneficiaries) takes over part of the private assets held by the founder, who is a private individual. As long as the private assets are held by the foundation, they are in limbo between the foundation and the future heirs/beneficiaries as private individuals. Provided the income is not distributed to the beneficiaries, this justifies taking account of the legal principles for the taxation of private individuals in the tax statutes of the foundation (principally designed in accordance with corporation tax regulations). In accordance with Luxembourg tax laws, private individuals can accumulate all kinds of investment income, including interest (shareholders cannot have their dividends paid out or capitalise interest e.g. by investing in capitalisation funds). Therefore, the authors of this draft legislation have transferred the tax position of the founder and/or their future beneficiaries to the foundation with regard to investment income. Taxation shall thus be deferred until “distribution”, in a similar way to that of a capitalisation fund. However, this shall apply solely to the taxation of investment income.

All other income of the foundation (e.g. rental income) shall be liable for corporation tax (currently 21%). As the purpose of the foundation is legally limited to asset management (interference in the management of a commercial company held by the foundation is prohibited), the foundation shall not be subject to business tax.

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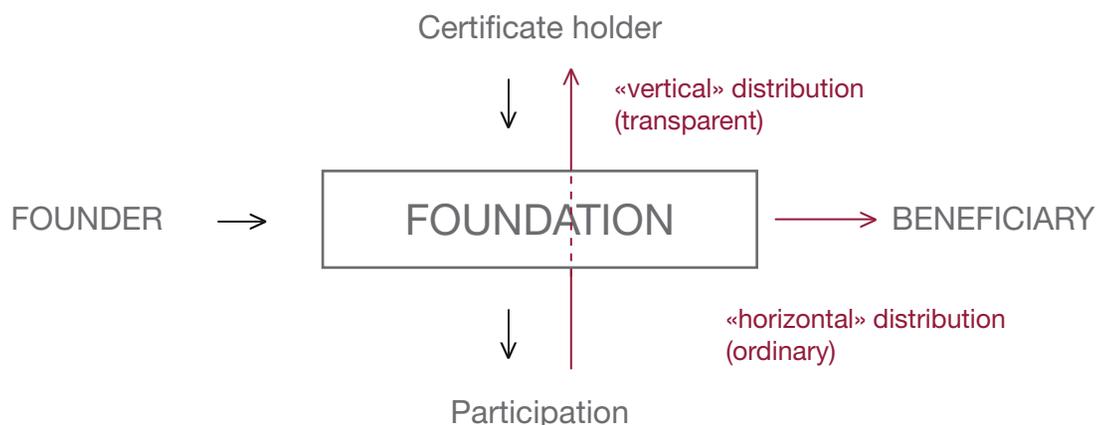
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“Distributions” and transfers

Deferred taxation on investment income shall be paid when the distribution to heirs/beneficiaries is made.

Ordinary or “horizontal” (see figure below) distribution / asset transfer: normal “distributions” or asset transfers to beneficiaries shall be taxed in accordance with the law governing the country of residence of the beneficiary. If the beneficiary resides in Luxembourg, “distributions” shall be regarded as other income and subject to a reduced tax rate. In line with the Luxembourg Income Tax Act, assets shall be transferred to the heirs or beneficiaries at book value in the case of transfers without consideration (inheritance/gift). Any possible capital gains shall only be taxed if the inheritance/gift (domiciled in Luxembourg) is sold on. This regulation was taken over for the foundation.

Special “vertical” distribution: in special cases, the draft bill also provides the possibility of securitising income or rights of transfer. The securitised claims issued by the foundation (e.g. dividends when dividend and voting rights are separated, or for securing particular benefit entitlements) shall be treated separately in terms of taxation. By way of exception, such income may be directly “passed” to the beneficiaries (tax transparency) without any income tax consequences (i.e. no change in the income type classification); the tax consequences shall be supported directly by the beneficiary. This is done with reference to Article 108 bis of the Luxembourg Income Tax Act, which governs the tax treatment of “usufruct” and similar legal relationships. The Dutch/Belgian Administratiekantoor was the model for this regulation.



Transfers to beneficiaries due to securitisation shall be made at book value. Gift tax consequences should also be noted, particularly if the beneficiary is not (potentially) an heir.

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Inheritance, gift and property transfer tax

According to international law, the applicable inheritance law, except in the case of immovable property, is determined based on the last habitual residence of the deceased (EU inheritance regulation). Often, this is not situated in Luxembourg. Basically, the same principle shall also apply to inheritance tax. The foundation itself shall not be subject to inheritance tax (thus there is no substitute inheritance tax payable annually or every 30 years - generation alteration fiction - as found in Belgium and Germany). However, the foundation is the liable party (and obliged to submit inheritance tax returns) if a testator/founder resident in Luxembourg incurs inheritance tax that is however not usually applicable for direct heirs resident in Luxembourg, as well as for their spouses and registered partners. Specific reference is made to the fact that some countries, such as Germany and France, also tax the heirs.

The same applies to gifts from the foundation during the lifetime of the testator/founder.

Transfers of securitisations relating to real estate located in Luxembourg shall be treated individually for inheritance, gift and property transfer tax in the same way as transfers of real estate.

Overall evaluation

The Luxembourg private foundation is a state-of-the-art, Europe-ready instrument that facilitates efficient cross-border asset management. In particular, you should consider this legal instrument if you are:

- an entrepreneur with pan-European interests or are thinking of opening branches abroad;
- the head or member of a “European” family wishing to centrally pool and manage your family’s assets for the sake of effective asset management.

The Luxembourg private foundation will be of particular interest if you have already thought about preparing a will or have contemplated succession planning.

However, this new instrument should also be of interest to many other asset management situations.

Exclusion from liability

The private foundation described here does not yet exist as a legal instrument. It consists solely of a draft bill currently making its way through the parliamentary legislative process. Legislators may make changes to this text at any stage during this process, which could render void the statements made above, either in whole or in part, and/or lead to other legal or fiscal consequences. In addition, the law may not be adopted at all. As a result, no responsibility shall be accepted for the accuracy of the above information. The sole purpose of this leaflet is to provide information on draft Luxembourg legislation.