

THE EUROPEAN ALTERNATIVE TO THE ANGLO-SAXON TRUST: UNIT-LINKED LIFE INSURANCE



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In this article, Nerea Llona, Tax & Legal Counsel - Spain and LatAm, interviews José Luis López-Hermida, Director, Tax - Family Office and Private Client at KPMG Spain, about the use of unit-linked life insurance as a wealth and succession planning alternative to Anglo-Saxon trusts for high-net-worth individuals in Spain.

WHAT TRENDS IN INTERNATIONAL HIGH-NET-WORTH MIGRATION AND WEALTH TAXATION ARE YOU CURRENTLY SEEING?

According to the latest data, it is estimated that more than 128,000 high-net-worth individuals will relocate during 2024. We are currently seeing significant tax changes in countries traditionally considered attractive to this client profile, which are fuelling this trend. For example, the United Kingdom, following its major reform of the tax regime for impatriates (the 'non-dom regime'), is expected to have the second-largest outflow of millionaires in the world this year. Similarly, Italy, which has traditionally attracted high-net-worth individuals, has doubled the cost of opting for the 'flat tax' regime (up to €200,000). Portugal also approved significant changes to its special tax regime for non-habitual residents at the end of 2023.

In four of the ten jurisdictions expected to have the largest outflow of millionaires in 2024 (i.e., UK 9,500, India 4,300, South Africa 600, and Taiwan 400), domestic laws include and recognise institutions such as the Anglo-Saxon-inspired trust.

This structure is also common among high-net-worth individuals from Latin America seeking legal security and asset protection in Spain. Despite not being new, the flow from these countries to Spain continues and is currently increasing.

Another global trend is the consideration of a possible increase in wealth taxation worldwide. For example, a study presented to the G20 countries proposes a minimum taxation of 2% on the wealth of billionaires¹. There is instability in the international tax landscape of wealth taxation, prompting two reflections: does it make sense for high-net-worth individuals to change residence to optimise their wealth, and are there vehicles that can facilitate such navigation while avoiding the limitations of a change in applicable jurisdiction?

The first question is very personal. Taxation of assets and flexibility in wealth management affect their profitability, preservation, and transmission to the next generations.

¹ A blueprint for a coordinated minimum effective taxation standard for ultra-high-net-worth individuals
Gabriel Zucman - 25 June 2024.

However, other factors should be considered when deciding on a change of residence, such as quality of life, cultural proximity, climate, security, social, business, and/or wealth ties. Relocation should not be based solely on 'tax reasons'.

Regarding planning vehicles, it should be clear that this is not limited to purely tax aspects. For wealth planning, the flexibility offered by the vehicle should also be considered, while always respecting the laws and regulations of each jurisdiction, for example, in civil matters or for inheritance purposes.

Spain currently has a special tax regime for impatriates, reasonably attractive for individuals who come to undertake certain entrepreneurial activities, work, or create wealth, also known as the 'Beckham Law'. With good estate planning, it is possible to optimise the taxation of the impatriate's assets and income under this regime.

Similarly, the Community of Madrid has recently announced interesting tax incentives to attract residents to Spain who make certain investments ('Mbappé Law'). While it is true that the continuity of residence visas for investment is under parliamentary discussion in Spain, this would not affect taxation.

WHAT INTERNATIONAL VEHICLES ARE COMMON AND WHAT DIFFICULTIES ARE CURRENTLY DETECTED FROM THE SPANISH POINT OF VIEW?

Internationally, various vehicles traditionally serve to structure assets for high-net-worth individuals.

One example is private holding companies (e.g., PICs). From the Spanish tax point of view, it is necessary to assess in each specific case how the international tax transparency regime (CFC rules) would affect a private wealth management legal entity, as it could imply anticipating taxation. Although in Spain there is a safe harbour for the non-application of this regime, such as harmonised collective investment undertakings subject to the 'UCITS' Directive², in the case of

any other type of corporate structure in the European Union or European Economic Area, its non-application would be based on proving the performance of economic activities, which sometimes may not be easy.

Another example is private foundations, which are specific to jurisdictions that recognise the protection of family wealth as a legal asset that can be pursued as a foundational purpose (e.g., Panama, Liechtenstein, Austria). In Spain, from a tax perspective, it should be remembered that if they are recognised as entities with their own legal personality different from the founder and distribute assets to the beneficiaries, there is a doctrine of the General Directorate of Taxation that considers that such distribution should be taxed as a gift between strangers (which could reach a marginal gift tax rate of 34% multiplied by 2.4).

Likewise, in the international sphere and particularly in Anglo-Saxon-inspired systems, the trust is a very common institution that allows the legal ownership to be separated from its economic ownership, the latter being subject to the rules that the settlor establishes regarding, for example, its succession and administration.

This means controlling the succession in a predetermined manner, safeguarding the good administration of the estate in accordance with the principles that the settlor considers appropriate. The management and custody of the estate is normally entrusted to specialised professionals such as trustees, and the handing over of the estate is conditional upon the settlor's wishes. Another advantage is the confidentiality of the trust's provisions, which does not mean it is tax efficient.

The arrival in Spain of investors from various jurisdictions (e.g., the United Kingdom, Latin America, Scandinavia, etc.) where trusts are a common vehicle for estate planning may pose operational, legal, and tax difficulties from a Spanish perspective.

As is well known, Spain has neither regulated trusts in domestic legislation nor has it recognised trusts constituted in a foreign country as an entity capable of owning assets and rights, not having signed the 1985 Hague Convention. This has generated a broad administrative doctrine that attributes the tax effects of the income, holding, and succession of assets within a trust to certain parties intervening in the trust structure (e.g., settlors or beneficiaries), i.e., the trust is considered transparent for tax purposes in Spain. What is not so well known is that the European Succession Regulation (Article 31 of EU Regulation No. 650/2012) establishes that when a person invokes a right that corresponds to him/her by virtue of the law applicable to the succession (remember that the Regulation allows a choice of law applicable to the succession, between nationality or residence) and the law of the Member State in which he/she invokes it does not recognise that law, it must be adapted to the closest equivalent right to the law of that State, if possible.

Another international vehicle that offers significant advantages in wealth management is the unit-linked life insurance contract (also known as Private Placement Life Insurance, PPLI or life assurance bond in some jurisdictions). It is similar to a trust due to the involvement of a professional manager and custodian to hold the assets underlying the policy. This structure provides flexibility in choosing who performs these functions, as well as in setting the terms and conditions for the payment of the insurance benefit by the insurer to the beneficiaries. All of this is backed by the legal security guaranteed due to the fact that it is a fully regulated contract under Spanish regulatory and tax laws.

² Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009.

WHAT DOES UNIT-LINKED LIFE INSURANCE OFFER AS AN ESTATE PLANNING VEHICLE?

Flexibility is key. In a volatile regulatory and tax environment, the flexibility provided by a life insurance contract is particularly valuable.

Under a unit-linked insurance contract, the policyholder can establish conditions and clauses in accordance with the applicable laws, based on the principle of party autonomy. Unit-linked life insurance is a useful instrument for estate and succession planning, allowing the payment of the insurance benefit to be deferred and divided according to the policyholder's instructions, regardless of the provisions of the last will and testament.

For example, the same policy can include different beneficiaries and payment conditions, whether *inter vivos* or *mortis causa*. It is also feasible to modify the beneficiaries whenever the policyholder decides to do so, provided there has not been an irrevocable designation.

Additionally, it is possible to plan how much and when the beneficiaries of a policy will receive payments, regardless of an unpredictable event such as death. This is because terms and conditions can be set for the payment of the insurance benefit, either on a fixed date (extendable or not) or, for example, conditional on the beneficiary reaching a certain age, or even postponing the payment to a date after death.

Another advantage shared with trusts is confidentiality, as it is a private contract between the company and the policyholder. The possibilities offered by a unit-linked life insurance contract in determining the applicable special conditions, as well as the beneficiaries, make it possible to plan the moment when the income is generated, and therefore its taxation. As long as the conditions established in the Spanish Personal Income Tax Law are met, the insurance contract shall offer tax deferral and various estate planning options.

For ordinary taxpayers who are resident in Spain and considering a possible change of residence out of Spain and hence, potentially subject to 'Exit Tax', structuring wealth through a unit-linked policy allows the potential tax cost of capital gains to be optimised.

For taxpayers in Spain under the impatriate regime, a unit-linked insurance policy taken out with a foreign insurer, which is not considered a right exercisable in Spain but abroad, allows optimising Wealth Tax or Solidarity Tax (non-taxable), as well as the income taxation (as it is not considered obtained in Spain).

In short, unit-linked life insurance allows, through careful study, advice, and specific planning of each case, to overcome the limitations that other common estate and succession planning institutions present in Spain (such as trusts), offering the necessary legal security and enabling high-net-worth individuals to navigate the complexities of international wealth taxation.

WHY A FOREIGN LIFE INSURER SPECIALISED IN UNIT-LINKED INSURANCE?

Currently, in Europe, the insurers with the highest level of specialisation and dedication to this vehicle are based in Luxembourg and Ireland. These countries have a long tradition of unit-linked life insurance, with in-depth industry knowledge from both the private and public sectors, including supervisors, regulators, and legislators.

The experience accumulated by international insurers in managing large assets, with the assistance of major custodians and asset managers, proves that this is a tried and tested instrument that has proven its worth and is particularly appreciated by those seeking security. These jurisdictions also offer specific advantages in terms of investor protection or even VAT savings, in the case of Ireland, for certain charges such as asset management charges, which can lead to significant savings for the policyholder.

In conclusion, unit-linked life insurance can be an interesting alternative in Spain for both inheritance and tax planning, as opposed to other structures that are not perfectly adapted to our legal system, such as trusts. It certainly provides flexibility and security when planning in such an unstable regulatory and tax environment.



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