Developments in Global Tax Transparency and the Need for Effective Dialogue (Part 1)

BY PHILIP MARCOVICI

This is Part One of the article, and Part Two will be published in the next edition of The World Financial Review.

Tax compliance is one of the many challenges different nations are facing. When we think of wealth owners "hiding" their wealth to evade taxation, Switzerland and the "Swiss Banks" immediately come into mind as key players, but Philip Marcovici sheds light on the fact that the issue is not a Swiss issue, but a global one.

The tax landscape for wealth owning families has been fast changing. Transparency and tax compliance are moving towards becoming the norm. This is a positive development given the financial challenges faced by governments seeking to address the needs of their populations and the growing inequality of wealth. But the road to transparency is not a smooth one.

For many years, the wealth management industry has directly or indirectly supported the misuse of bank secrecy to the detriment of both interested governments and wealth owning families who are increasingly realising that apart from being the right thing, tax compliance can be far cheaper and safer than tax evasion. There have, of course, been a number of voices pushing for transparency and compliance over the years, but the approach of too many in the industry has been to resist change and to perpetuate the ways of the past – which ways are inappropriate in today's world.

Wealth owning families need to hear the truth, and to be guided by their advisors as to how to best navigate a fast-changing and increasingly transparent landscape.

In the case of the private banking and trust world, secrecy all too often was the basis for planning, with aggressive or outright evasive approaches being adopted on the logic that "no one would ever find out". Indeed, private banks and trust companies in a number of jurisdictions marketed bank secrecy and, in effect, tax evasion, as a luxury product, available to those with the wealth and contacts needed to attract

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them offshore. In this regard, it is easy to think of Switzerland as the dominant player, but it would be a mistake to fail to recognise that the issues of abuse of bank secrecy and tax evasion are not Swiss issues – they are and will continue to be global issues. Interestingly, the US, in a time of increased information exchange, is emerging as a hotspot of undeclared money seeking a new home.

The wealth management industry has not done a good job of proactively leading on developments in and around growing transparency. To a large extent, the industry has been reactive, defending the past rather than working out how best to cooperatively address the needs of all stakeholders. This lack of strategy has resulted in the future of the industry being dictated not by the industry itself, but by others, including onshore governments, which themselves are not necessarily achieving their real objectives.

For many years, arguments on behalf of offshore centers seeking to preserve the past have focused on the notion of a "level playing field", pointing to bank secrecy and the use of opaque structure in countries such as the US as a rationale for continuing past practices. The reality, however, is that onshore countries have every right to tax their residents (and sometimes citizens) as well as foreigners who invest in their countries. But onshore governments need help from those who really understand the world of trusts and other tools used by wealth owners to

arrive at ways to balance the need for information with proper privacy protection. The industry failing to recognise this reality has led to a tsunami of over-reaction to the detriment of the industry and the families it serves.

Over-reaction by governments has ranged from punitive and overly-intrusive reporting and taxpaying requirements associated with the use of trusts to aggressive attacks on private banks and others for past practices.

Professionals and the associations that represent them have a special and important role to play in not only educating themselves and their members on global change, but to help educate onshore and offshore governments and to help smooth out the rough road to transparency ahead. To date, the industry has not done enough.

It is time to be far more proactive, to the benefit of all stakeholders.

Tax Evasion and the Misuse of Bank Secrecy is a Global Problem – Advisors Need to Look Beyond Their Own Borders

Many things have been happening to help move the world into transparency, and the Swiss landscape in particular has been changing fast and in a very public way. These changes are also happening on a global basis, but with somewhat less effect in some places over others. The reality, again, is that the issue of misuse of bank secrecy and tax evasion is a global one.

Interestingly, but not surprisingly, respect of tax laws seems to have carried greater sway when the laws involved were those of the jurisdiction or advisor involved rather than those of another country. For example, it is not unusual to see American private banks having evidenced a history of being far more careful about US tax evasion than the evasion of taxes of other countries by their clients. Similarly, UK, Dutch, French and other banks seem to have evidenced greater sensitivity to what they do with clients from their own countries as opposed to others. Typical private banking centres like Switzerland developed an attitude that the laws of other countries were simply not relevant, with Swiss bank secrecy and related rules being the only ones to pay attention to.

The adoption of varying standards of ethics on the issue of tax compliance has also extended to the community of professional advisors and others involved in the industry. In my experience, even top tax lawyers in Miami and New York tend to pay far more attention to the question of US tax compliance than the tax compliance of global families in their home countries. Today's advisor (and, frankly, yesterday's should have also done this) must look at tax compliance as a *global* issue, meaning that when a Venezuelan or Mexican invests in the US and is guided by a US tax lawyer, that lawyer must properly liaise with Venezuelan or Mexican advisors to ensure that the overall approach adopted is tax compliant – not only in the US but in all relevant jurisdictions of residence and investment.

Undeclared funds are a global problem, and measurement of the amounts involved is very difficult. The Tax Justice Network has reported the figures involved to be as high as over US$30 trillion. Oxfam has estimated that if taxes were properly paid by those earning the income involved, global poverty would be eliminated twice over.

The Express Train to Automatic Exchange of Information Backed Up by Effective Anti-Money Laundering Rules – But will it Always Work?

There is now rapid progress towards the adoption of global approaches to automatic information exchange, a dramatic departure from the methods of information exchange of the past, such as information exchange upon request. This progress is based on work of, among others, the US, the UK, the OECD and the EU.

The US has made great progress in implementing its Foreign Account Tax Compliance Act ("FATCA") approach to tax compliance, and this has, in turn, made it easier for the OECD, with the support of the UK and others, to use FATCA as a basis for the development of a global standard (the Common Report Standard, or CRS) for automatic information exchange. The EU has been successful in moving forward with implementing automatic information exchange between its members, replacing its loophole ridden European Savings Directive. Automatic exchange of information using the CRS, which focuses on the role of banks and other financial intermediaries in documenting the ultimate beneficial ownership of vehicles such as companies and trusts, represents a sea change

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and the full involvement of the financial services industry in tax compliance and enforcement.

The ability of automatic information exchange to address the global issue of undeclared funds is substantial. An important, but sometimes overlooked, element of tax enforcement relates to the move to have anti-money laundering rules include tax crimes as predicate offences, something that has already been introduced in many countries, including the UK, Singapore and Hong Kong. Through changes to EU anti-money laundering rules and initiatives of the Financial Action Task Force, we increasingly close to comprehensive anti-money laundering rules in key financial centers that include tax offences as anti-money laundering offences.

Combining the impact of anti-money laundering rules that are effectively enforced (today, they are not) with bi-lateral and multi-lateral automatic information exchange arrangements, undeclared money should be significantly reduced. A bank, for example, in a traditional bank secrecy country (of which there are many, such as Switzerland, Singapore and others), will, where the anti-money laundering rules so provide, have to be comfortable that monies on deposit are tax declared in the home country, failing which anti-money laundering reports will need to be made. Connected to this will be automatic exchange of information agreements, whether or not part of comprehensive tax treaties, that require information to be automatically exchanged regarding the earnings of taxpayers connected to countries that have entered into automatic exchange agreements. Important to note is that anti-money laundering rules will apply even where there is no automatic exchange of information yet agreed with the relevant home country – but what happens in these cases is not yet clear.

Developments towards global transparency include initiatives to require the creation of public

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registers on beneficial ownership. While the debate continues, there are moves towards this for companies, trusts and other investment and asset holding vehicles. This links closely to automatic exchange of information, but some of the proposals are clear over-reactions to the abuses of the past that are increasingly coming to light and may carry with them many problems over and above the challenge to the human right to privacy.

Where countries have the economic and other power to be early on the list for automatic exchange of information, these countries will benefit their tax systems early on. This is already happening in relation to the U.S., with its rollout of FATCA, and will be the case for many European financial centres, and others of developed countries in particular, as part of OECD and EU initiatives.

Two realities, however, among many:

First, countries will only have capacity to negotiate and enter into a limited number of automatic information exchange agreements in the short and medium term, and the priority will clearly be to do so with countries, like the US and certain Western European countries, that are pushing this on their agenda, and who have the negotiating power to force counterparts into such arrangements, such as where a comprehensive tax treaty can be threatened if automatic exchange is not agreed to.

Second, many financial centres are adopting strategies designed to "go slow" in the sense of allowing loopholes in anti-money laundering rules (this through the requirement of "double criminality", among others, which means that if something would not be a tax offence in both countries involved, no reporting arises) and through a selective (and sometimes conditional) approach to entering into bilateral exchange of information agreements. Broadly, the financial services industry and financial centres are focusing on the developed world and counterpart financial centres as the first countries to automatically exchange information with…low on the priority scale are countries most in need of tax revenues, those that are developing and which may have other problems with their tax systems. These countries that are most in need will be the least likely to gain in the short or medium term.

Are All Countries Ready for Automatic Exchange of Information?

While for the moment, anti-money laundering rules are generally not being overly enforced when it comes to taxpayers from many developing countries, as such rules do become better known and focused on, the risks to wealth owners from fragile countries will increase. The reality is that not all countries are actually ready for the full tax transparency that the world is working towards. What happens where a taxpayer is a resident of a developing country the tax system of which does not respect privacy, meaning that information the tax authorities have is improperly made available

Switzerland and its banks are again under attack over possible tax evasion © Keystone, 2010

The wealth management industry has a key role to play in helping the world address the issue of undeclared money. This role is a responsibility not only of the wealth management industry, but of wealth owners and all who advise them.

to journalists and others, perhaps including kidnappers interested in knowing who has what? What if there is corruption in the tax system, and tax proceeds are, in part, diverted improperly? What if information on an individual's assets and income lead to a corrupt approach to a bribe to avoid a full tax audit? And what of countries that use tax information to attack the political enemies of the state?

Taxpayers connected to countries whose tax systems are not ready for full transparency will be forced into finding ways to avoid new reporting and compliance systems, in part relying on the insufficiency of the home country tax system to fairly tax income. In some cases, taxpayers may be encouraged to abandon their residence to avoid being taxpayers, something that contributes little to the local economy. In other cases, untaxed assets might be converted into investments that do not attract the tax compliance that passive investment portfolios with banks attract – commodities in safe deposit boxes, opaque business and real estate investments and otherwise. Again, not something that encourages investment into the home country which needs it most. Sadly, it is the entrepreneurs who can hugely benefit a home economy with their knowledge and experience of the country that are encouraged to invest abroad and find ways to distance themselves economically and otherwise from the place they know best. Meeting the tax laws of many developing countries is simply not an option given the practicalities of how the tax system operates.

The wealth management industry has a key role to play in helping the world address the issue of undeclared money. Given the abuses of the past, and the need for society to focus on the reality of income and wealth inequality, this role is actually a responsibility…not only of the wealth management industry, but of wealth owners and all who advise them.

A continuation of the industry's historical reactive approach to change will serve both the industry and wealth owning families badly. There is a need for leadership and dialogue, with a focus on outcomes that can benefit all stakeholders.

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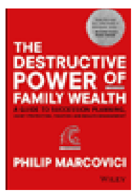
In the next edition of The World Financial Review, Part Two of this article will explore alternatives that might be considered to address the reality that not all countries are ready for full transparency and the automatic exchange of information. Switzerland's failed strategies will feature, as will the role of the wealth management industry and other stakeholders in encouraging effective dialogue.



Philip Marcovici is retired from the practice of law and consults with governments, financial institutions and global families in relation to tax, wealth management and other matters. Philip was a Partner of Baker & McKenzie, a firm he joined in 1982, and practiced in the area of international taxation throughout his legal career. Philip retired from Baker & McKenzie at the end of 2009. In 2013, Philip received a Lifetime Achievement Award from the Society of Estate and Trust Practitioners. In 2016, Philip had his latest book, *The Destructive Power of Family Wealth*, published by John Wiley & Sons.