Privacy in Times of Financial Transparency

Interview with Philip Marcovici

Philip Marcovici is a member of the Board of Directors of Kaiser Partner Holding and its subsidiary companies. After retiring from legal practice, which includes almost 30 years with international law firm Baker & McKenzie, he continues to advise families, companies and governments on tax compliance and international tax policy.

Q: Mr. Marcovici, we already live in a cross-linked world. Is the Common Reporting Standard (CRS) just a sign of this or will this initiative be a significant push towards increased transparency of our financial data?

There is no question in my mind that we are at the beginning of the road to a transparent world. There is much more to come in terms of increasing transparency in relation to the assets and income of wealth-owning families. I always emphasize the importance of full compliance with tax laws, advising wealthy individuals on the advantages of 'playing by the rules'.

Throughout my career I have helped banks and trust companies understand the needs of their clients. Unfortunately, there are still some advisors who do not recognize the realities of today's world. The road to transparency will increasingly be a rough one on many fronts, and wealth owners need to be prepared and well-informed to avoid the potential bumps ahead. I am very worried about the loss of privacy CRS and other transparency initiatives will result in. It is a real concern that governments will be getting much more information than they really need to ensure tax compliance. An even bigger concern is that many of the governments that will be receiving such information are simply not ready for it, given that their tax and legal systems do not adequately protect taxpayers from the misuse of their personal information.

Q: Critics of the CRS say that the authorities will hardly be capable to handle the huge amount of information. What advice would you give wealth owners? Does this mean they can sit back and relax?

It is true that the volume of information that governments will be receiving under CRS (and through other means, such as suspicious activity reports under anti-money laundering legislation that includes tax fraud as a predicate offence) will be huge. Few countries will be able to cope with the information they receive, but it would be a big mistake for wealth owners to assume that this is reason enough to relax.

Governments will learn how to handle the information they receive, and as technology and cooperation between governments improve, dealing with vast amounts of data will get easier and easier. Governments, even in the short term, will be looking for tax evaders to make examples of. Wealth owners should ensure that they are tax compliant so that they really can sit back and relax.

Q: Why is it wise to talk with your wealth manager about CRS?

One of the most important things a wealth owner needs to do to maintain privacy while ensuring full tax compliance, is to review who will be getting what information on them, their family, and on the income and assets they have an interest in. If a wealth owner has a variety of bank accounts, some in structures, some not, or in various jurisdictions, the wealth owner needs to engage with their wealth manager and ensure that all intermediaries have the right beneficial ownership and residence (and citizenship) information, and clarify what information will be going to which countries. There are many banks and other intermediaries confused about the rules, and where trusts and foundations are involved, information on 'controlling persons' may result in the wrong countries getting the wrong information, and giving rise to significant disputes. Best is to review the situation upfront, ensuring that there is common agreement as to what information will be going where. I have seen some banks and trust companies more worried about their own position than that of their clients, something that can lead to more information being provided than the law actually requires. How structures, such as trusts and foundations, function and where they are located can significantly affect the flow of information. Every wealth owner should be conducting a tax compliance and privacy audit — a check on whether they and their family are tax compliant and whether the right countries will be getting the right information under CRS.

Q: Given that CRS may give rise to information regarding a wide range of structures and holdings coming to light, is a voluntary disclosure the right way to clarify the situation?

It is absolutely in the best interests of families to take advantage, as soon as possible, of voluntary disclosure and other approaches to regularization of their tax affairs if this is needed given their tax position. Many countries offer attractive voluntary disclosure possibilities, and others are developing new voluntary disclosure approaches in view of automatic exchange of information. It is always the right thing for wealth owners to proactively deal with any issues in and around undeclared assets and income rather than waiting for tax authorities to address these matters. R

Thoughts on
Mobility and Related Planning

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Play by the rules or get out. These are the only choices wealth owners have. Staying connected to a country by residence, domicile, citizenship or otherwise and hoping that no one will find out is simply not an option in a world of growing transparency, especially one where tax laws are increasingly and more aggressively enforced. Tax laws are laws, and there is no choice but to comply.

'Getting out' means sorting out any historical tax liabilities, exiting a tax system, and finding a new, more favorable one. Given the upcoming Automatic Exchange of Information between countries, many countries are moving to ensure that there are reasonable means for taxpayers to regularize their historical tax affairs, recognizing that this will increase revenues and help ensure long-term tax compliance. This represents an opportunity to review the current situation and make some strategic decisions. Once historical tax issues are addressed, and the wealth owner is clearly 'playing by the rules', they can consider the important question of whether 'getting out' is a good option.

Mobility — taking advantage of the ease with which a wealth owner can move from one country to another — is not only an important element of tax planning, but also plays a crucial role in the achievement of other objectives wealth owners may have. The reality is that different countries have different tax rules, and where someone lives, holds citizenship or is domiciled may drastically affect tax exposures. Apart from tax, residence choices will affect what information which government will hold about a wealth owner's income and assets — an important issue in a world where challenges to wealth are steadily increasing, and where it is not always safe for information about wealth to fall into the hands of governments. Those looking to acquire increased mobility almost always begin by asking the wrong question: How long do I need to spend in (Monaco or the Bahamas or wherever) to be a resident there? The first step should be to find out how to exit the country you are currently connected to, whether by residence, domicile or citizenship.

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A growing issue when leaving the taxing jurisdiction of a country is exit taxes. An increasing number of countries (for example Canada) are imposing an exit tax on those who give up taxable residence (and in the case of the US, citizenship or long-term green-card status), often through a deemed sale of assets at fair market value on the date of departure. Residents leaving the country are taxed on their departure based on the assumption that they will have sold their assets by the time they leave. Capital gains tax applies if the individual owns appreciated assets. Where exit taxes apply and there are rules that deem the sale of assets on departure, it is useful to consider an exit when asset values are low, such as during an economic downturn. In a wealth-owning family, it is also relevant to consider having the younger family members undertake mobility planning before and not after they come into wealth. Once planning regarding leaving a country has been undertaken, the next question that arises is where to go or where to obtain a second or further citizenship.

The wealth owner often faces a variety of choices. Obvious tax-advantaged choices include jurisdictions that impose no tax at all, such as the Bahamas or Dubai. Other choices include countries that impose tax on a territorial basis, such as Hong Kong or Singapore, where a resident (or non-resident) only pays tax on their locally sourced (not worldwide) income. There are also a number of countries that offer special 'deals' on taxation for specific groups of taxpayers. Careful planning of one's

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affairs is necessary to reflect the way in which one's new country imposes tax, and it is critical to take steps before becoming a resident of the new country. Demand for mobility is increasing, resulting not only in more exit taxes, but also in greater difficulty in obtaining resident permits in places like Hong Kong and Singapore, as well as higher costs for those seeking to take advantage of tax-attractive locations. Interestingly, there is much one can do before moving, even to what may be perceived as a high-tax country. A variety of approaches – sometimes involving trusts and other wealth-planning 'tools' – becomes relevant. For a retiring couple, for example, some simple steps can reduce tax dramatically before moving to a new country. Gifting assets to children directly or through structures, for instance, may well result in the assets no longer being owned. This means that the taxation of income earned on those assets will be avoided in the new country of residence.

Citizenship is available in a number of circumstances, for example as a result of family history or religion. A number of countries have laws that consider the children and further descendants of a citizen as citizens too. So if your mother or grandfather was born in a particular country, you may find that you are eligible to become a citizen of that country. In fact, you may already be a citizen, in which case you merely have to prove your right in order to obtain a passport as proof of that citizenship. There are also countries that offer citizenship. This is often achieved through investment and other programs. The countries involved may even be members of the European Union, affording their citizens freedom of movement within Europe and wide access to visa-free travel to many countries.

Other countries, like Australia, Canada and the UK, may require a considerable period of physical residence before citizenship can be obtained. But unlike the US, once citizenship is obtained (even if one is not resident there), one is taxed only on locally sourced income. In the longer term, it is likely to become increasingly difficult to obtain and keep second, third and further citizenships. As in the area of mobility, where there is an increasing number of countries that impose exit taxes, and whose residence and related rules are getting tougher all the time, it is likely that more countries will seek to limit the circumstances in which multiple citizenships are permitted.

For now, however, multiple citizenships can be an important safety net for wealth-owning families, and not only from a tax perspective. R

This article is an excerpt from Philip Marcovici's latest book, *The Destructive Power of Family Wealth*, published by John Wiley & Sons Limited, and reproduced with kind permission.