Wealth Management

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Feature

Jersey

The Royal Court provides guidance on the ratification of acts done by invalidly appointed trustees

by Eren Kilich and Louise Oakley (London)

In the Matter of the Z Trust [2016] JRC048

The Royal Court in Jersey recently heard an application by a beneficiary to set aside an appointment of trustees due to the adverse tax consequences resulting from that appointment. The Court, without much deliberation, held that the appointment should be set aside. However, it was then faced with the more problematic question of how to deal with the acts done by the invalidly appointed trustees.

The Court's decision provides useful guidance that tackles the issue of whether the acts of invalidly appointed trustees can be ratified and, if not, what consequential orders should be made. Two aspects of the judgment are of particular importance. First, the Court provides an academic analysis of the case law on the issue of ratification, focusing on the somewhat controversial decision reached in *Re BB*[1] . Secondly, the judgment advocates an innovative solution, aimed at better meeting the objectives of the parties involved, whilst producing much the same effect as ratification.

Background

A discretionary trust was established by deed of settlement, governed by Jersey law and its principal asset was a shareholding in a wholly-owned, foreign-registered company (the "Company"). The Company owned a leasehold interest in a flat (worth two thirds of the value of the trust) and a freehold property (worth one third of the value of the trust).

The settlor exercised her power to appoint two London-based solicitors (the "Purported Trustees") as trustees in place of the existing Jersey-based trustee, who retired (the "Retired Trustee"). In addition, the offshore officers of the Company were replaced with onshore ones and the shares in the Company were transferred and vested in a nominee for the benefit of the Purported Trustees.

The settlor decided to appoint the Purported Trustees in the belief that moving the administration of the trust from Jersey to London would better protect the assets of the trust. In particular, she believed that the Retired Trustee was threatening to sell the flat for an undervalue and was also concerned that her wider family might be able to take the trust assets, after one of her children (who was at the time a beneficiary) requested information about the assets from the Retired Trustee. The settlor had taken preliminary tax advice but, as no calculations had been undertaken, was unaware of the extent of the tax consequences of the appointment.

The settlor passed away less than a year after the appointment and, approximately one year later, the Company sold the leasehold interest in the flat and distributed the sale proceeds to the Purported Trustees. Following this, the Purported Trustees distributed funds to one beneficiary and permitted that beneficiary to occupy the freehold property gratuitously.

As a result of the acts done by the Purported Trustees following their appointment, corporation and income-tax charges on the Company and the trust were incurred, amounting to approximately 32 percent of the value of the entire trust fund.

[1] Re BB [2011] JLR 672

Decision

The Court reversed the appointment of the Purported Trustees using its powers under Article 51, 47G and 47H of the Trusts (Jersey) Law 1984.

Article 51 provides that the Court may set aside the appointment of trustees on the basis that the power of appointment was not exercised in the interests of all the beneficiaries. The settlor was found to have only taken into account the interests of one of the beneficiaries under the trust - her spouse.

Article 47G gives the Court the power to set aside the exercise of powers due to mistake. The settlor was found to have made a number of mistakes. She did not understand that the power of appointment was a fiduciary power that needed to be exercised in the interests of all the beneficiaries; she failed to understand the actual implications of the tax consequences resulting from the appointment; and she wrongly believed that the appointment would provide greater protection for the trust assets from her wider family.

Article 47H provides that the Court may set aside the exercise of fiduciary powers where the person exercising a power failed to take into account relevant considerations, or took into account irrelevant considerations. The Court found that the settlor had taken into account an irrelevant consideration as a result of her irrational fear of her wider family's actions in relation to the trust property if it remained held by Jersey trustees. In addition, she had failed to take into account the actual tax consequences of the appointment.

Finally, the Court noted that Article 47I(3) and (4) of the Trusts (Jersey) Law 1984 provided it with the power to make such consequential orders as it thought fit.

Consequential orders

Following the Court's decision to set aside the appointment, the applicant beneficiary, along with the Retired Trustee and the Purported Trustees, sought ratification of the acts carried out by the Purported Trustees. Even though the Purported Trustees were relieved of personal liability, their actions could still be challenged on the basis that the Retired Trustees did not participate in them and/or that the powers they exercised as trustees *de son tort*[2] were not open to them.

In making the application, the parties relied on the decision in *Re BB*. In that case, the Court ratified the actions of a trustee *de son tort* on the basis that it had the power to do so under Article 51 of the Trusts (Jersey) Law 1984 and/or the Court's inherent jurisdiction.

However, in the present case, the Court was not satisfied to rely on the decision in *Re BB*, as this decision had been the subject of adverse, albeit non-judicial, commentary. The Court quoted an extract from one article, in which the author, Francis Tregear QC, contended that there was no "*overwhelming confidence that Article 51 did the trick*" and "*[f]or such a dramatic and magical effect there was not a great deal of argument or analysis as to the precise scope and effect of ratification*"[3]. As such, the Court invited further submissions from the parties to help it to draft appropriate orders.

A legal opinion was produced by Lynton Tucker, one of the senior editors of the 19th Edition of Lewin on Trusts (2015). Mr. Tucker identified three different types of ratification or confirmation:

1. Confirmation by perfection of an imperfect act or transaction.

2. Confirmation by replacement of a tainted or doubtful act or transaction by an effective one with a similar effect.

[2] A trustee *de son tort* is a person who intermeddles with the affairs of a trust without being lawfully appointed to the office of trustee.
[3] F. Tregear QC, Trusts & Trustees, vol. 19, no. 1, February 2013, pp. 23-30.

3. Confirmation by non-intervention in acts or omissions which were not or may not have been authorised, so that these acts or omissions remain undisturbed.

Of these types of ratification or confirmation, the Court elected to incorporate into its orders confirmation by replacement and confirmation by non-intervention. Mr. Tucker suggested that these would better achieve the objectives of the parties than the first kind of ratification for a number of reasons.

Firstly, it was contradictory to set aside the appointment and hence the acts done by the Purported Trustees, only to ratify some of them later. In contrast to in *Re BB*, in which the objective was to confirm everything done after the void appointment of trustees. Secondly, the Court did not have the power to ratify the acts done at company level. Instead, the second and third forms of confirmation could be used to authorise and direct the duly constituted trustees to procure and allow the Company to be administered on the same footing as though the acts and omissions in question had been procured by duly authorised trustees. Thirdly, there was a risk that ratification could have adverse tax consequences. HMRC would be at liberty to argue that ratification by the Jersey Court endorsed and provided a legal basis for management and control being lawfully carried on in England. Fourthly, following the decision of the English court in *Jasmine*[4], the Court doubted whether ratification could be used to validate the invalid exercises of dispositive powers. Lastly, some of the acts to be validated were made pursuant to a Court order, and so ratification would not be necessary or appropriate. Mr. Tucker suggested that it would be preferable for the Court to direct that nothing in the orders prejudiced the payments made pursuant to the Court orders.

Importance for trustees and beneficiaries

This case should go some way to easing concerns, following the criticism of Re BB, that the Courts may not have the power to validate acts done by invalidly appointed trustees. In particular, the Court's use of confirmation by replacement and confirmation by non-intervention provides authority for these alternate and indirect methods of achieving ratification. As a result, applicants for ratification may begin to seek orders in such terms. The forms of confirmation that the Court elected to incorporate into its orders are attractive not only because they escape the criticism levelled at ratification in Re BB, but also because they can be used to validate the use of dispositive powers and avoid any unintended adverse tax consequences that could result from ratification.

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[4] *Jasmine Trustees Ltd v Wells & Hind* [2008] Ch 194

Case Summaries

China

Shandong case: Trustee escaped tax on trust income

by Amy Ling (Hong Kong) and Jinghua Liu (Beijing)

In the June 2016 Issue of Taxation Research, two tax officials from the Laoshan State Tax Bureau in Qingdao, Shandong Province reported a case in which a trust company successfully defended itself from tax on trust income.[5]

Facts

In June 2012, a Chinese trust company ("Trustee") injected RMB600 million into a real property development company in exchange for 16.02 percent shares in the real property development company. The RMB600 million that was used for the capital injection were trust assets entrusted by another Chinese company ("Settlor"). In May 2014, the Trustee transferred the 16.02 percent shares for RMB702 million.

The tax bureau learned about the share transfer through the real property development company. The tax bureau decided that the Trustee had realized a capital gain of RMB102 million from the share transfer and informed the Trustee to pay an additional RMB25.5 million in taxes (i.e., RMB102 million * 25 percent).

In response, the Trustee argued that it should not be taxed on the share transfer because the transferred shares were trust assets rather than its own assets. The Trustee further argued that the Settlor who was the beneficiary should pay tax on the share transfer. To support its argument, the Trustee provided the tax bureau with documents issued by the local Banking Regulatory Bureau and the local Administration of Industry and Commerce to show that the transferred shares were trust assets.

The tax bureau conceded the argument to the Trustee and shifted its focus to the Settlor. The tax bureau found that the Settlor had not recorded any income on the share transfer. The tax bureau then informed the Settlor's in-charge tax bureau to collect the unpaid tax.

Observations

Currently, China has few specific rules addressing the tax treatment of trusts other than regulations on taxation of commercial trusts with securitized assets. Under the PRC Trust Law, a trust is a pure contractual relationship.

In a report[6] issued by the SAT in 2003, the SAT proposed taxing the trustee on trust income and then taxing the beneficiary on the distribution of the trust income with credits for taxes already paid on that trust income available. In this case, the tax bureau took a different position and passed over the Trustee probably because both the Trustee and Settlor (beneficiary) were Chinese enterprises and therefore China's tax rights were not affected by who was named as the taxpayer. But where the trustee and settlor are non-residents, the tax bureau might be more inclined to follow the 2003 SAT proposal. Thus, it remains unclear how trust income will be taxed in China.

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[5] See Taxation Research (June 2016 Issue), pp. 76-77.
[6] Trust Taxation Research Team of the State Administration of Taxation, *Report on Establishing the PRC Trust Taxation Mechanism*, dated 4 May 2003.

Hong Kong

Hong Kong Court of Final Appeal confirms money laundering offence does not require actual knowledge nor does the property need to be actual proceeds of crime

by Cynthia Tang, Mini vandePol, Anthony Poon, Bryan Ng and Roberta Chan (Hong Kong)

There are increasingly aggressive efforts by regulators and now by the judiciary in Hong Kong in combating money laundering. The recent judgment of the Hong Kong Court of Final Appeal ("CFA") in *HKSAR v Yeung Ka Sing Carson*[7] ("Carson Yeung Appeal") serves as a timely reminder of the potential substantial risks in failed AML efforts. The CFA has confirmed, among other things, that on a charge of dealing with proceeds of crime contrary to s 25 (1) of the Organized and Serious Crimes Ordinance ("OSCO"), the prosecution only needs to show that when an accused dealt with certain property, he or she knew, or had reasonable grounds to believe that such property represented the proceeds of an indictable offence. The property does not need to be actual proceeds of crime. It is said by the CFA that there are strong policy reasons favouring this conclusion. This article will discuss the *Carson Yeung Appeal* and what clients can do when faced with suspicious transactions.

Implications for clients

The *Carson Yeung Appeal* has important implications for clients who are handling and transferring funds. The prosecution will not need to prove that the property being dealt with was in fact the proceeds of an indictable offence (i.e. tainted assets). As the mental element of the offence is either knowing or having reasonable grounds of belief, actual knowledge is not required. If there are circumstances which may impose a suspicion or reasonable belief (that the relevant property is tainted), this means caution has to be exercised before dealing with it.

The CFA judgment

By way of background, in 2011, the former Birmingham City Football Club chairman Carson Yeung ("Yeung") was convicted in the District Court on five counts of dealing with property believed to be proceeds of an indictable offence for laundering more than HKD700 million in Hong Kong. The District Court heard various parties including securities firms, which made more than 900 deposits into the accounts in question between 2001 and 2007. The court ruled that Yeung dealt with those deposits and found that he knew or had reasonable grounds to believe that those funds were the proceeds of an indictable offence. On 11 July 2016, the CFA dismissed Yeung's appeal. The following are some of the key points in the CFA decision.

1. The CFA confirmed that the legislation no longer requires proof that the property dealt under section 25(1) consists of the actual proceeds of an indictable offence. It is only necessary for the prosecution to establish that the accused dealt with certain property, in circumstances where he or she knew, or had reasonable grounds to believe that such property represented the proceeds of an indictable offence.

2. The mental element of the offence is either knowing or having reasonable grounds to believe that property being dealt with represents any person's proceeds of an indictable offence. If an accused is proved to have known that the property represents such proceeds, the offence is established.

3. If the defendant does not have actual knowledge, it is sufficient for the prosecution to establish that, given the circumstances of which he was aware, surrounding his dealing with the relevant property, the defendant had reasonable grounds to believe that it represented the proceeds of someone's indictable offence, whether committed in Hong Kong or abroad.

[7] FACC No.5 and 6 of 2015

4. The harshness of the approach can be mitigated by disclosure to the authorities of suspicious transactions which has always been a central feature of our legislative regime.

5. The Court endorsed its earlier decision in *HKSAR v Pang Hung Fai* (2014) that the prosecution needs to prove that the accused "*had grounds for believing, and the grounds must be reasonable, that anyone looking at those grounds objectively would so believe*." This involves an examination of the accused's state of mind in two aspects. First is his knowledge or appreciation of the circumstances of the proven reasonable ground. The second aspect refers to a consideration of his personal beliefs, perception and prejudices, which may exclude a culpable state of mind.

Actions to consider

The legislation gives "dealing" a wide definition to include receiving or acquiring, concealing or disguising, disposing of or converting, bringing into or removing from Hong Kong that property; or using it as security to raise funds. Clients should be highly vigilant as to the source or circumstances of any transfer or deposit of funds. The CFA decision mentions that if a person does not know but has reasonable grounds to believe that funds are tainted, the law gives him the means to immunise himself from liability by disclosing his suspicion to the authorities to facilitate further investigation. We recommend the following steps:

1. Know your client, with an on-going monitoring of the client's risk profile and understand the source of funds.

2. Establish effective mechanisms for identifying and reporting suspicious transactions.

3. Maintain an effective internal audit system.

4. Promptly seek legal advice when faced with any suspicious transactions with a view to making disclosure to the authorities.

5. Conduct regular training for employees on anti-money laundering in order to enhance their awareness.

6. Be aware of any updated information published by the Financial Action Task Force on money laundering issues.

Conclusion

The *Carson Yeung Appeal* is a good reminder of the importance of compliance, in terms of safeguarding against illegal activities like money laundering. Clients should always stay alert and most importantly, disclose any suspicious transaction immediately once they have reasonable grounds to believe that it relates to money laundering.

Switzerland

Swiss banks must give your money back

by Valentin Roten and Frédéric Betrisey (Geneva)

Once upon a time in the Swiss banking sphere, it would have been clearly out of the question for the banks to poke their nose into their client's business.

That now belongs in the past.

Indeed, in light of the brisk developments towards automatic exchange of information and following significant fines imposed by American authorities in regard to accounts held by some American citizens in Swiss banks, the latter have drastically modified their approach.

Once bitten, twice shy, some Swiss banks are now even reluctant to return the money of certain clients if these clients refrain or refuse to produce a tax compliance statement regarding their banks accounts.

Is this method legal ? Well, some clients have had to defend their rights in court in order to know if it is.

In October 2015, the Supreme Court of Switzerland gave its opinion on that matter through two rulings[8]. In these rulings, the Supreme Court mentioned that the clients were "in principle" entitled to obtain the return of their own money. In both cases, the clients won. Unfortunately, the Supreme Court did not rule in favor of them by rejecting the arguments of the bank, but because of infringements of procedural provisions made by the bank.

In other cases, some local Courts ruled that the retention of the money by the bank against the client's will did not constitute a coercion within the meaning of Article 181 of the Swiss Criminal Code[9].

On the contrary, it was considered that the bank account statement could constitute a sufficient acknowledgement of liability of the bank towards its client so that the client would have a facilitated path through debt collection proceedings.

Meanwhile, no Swiss court had really addressed the issue of whether the legal arguments put forward by the banks in order to refuse to return the money of their clients were lawful or not.

Judgments of the Court of First Instance of the Canton of Geneva in February 2016

In February 2016, the Court of First Instance of the Canton of Geneva delivered two important and similar rulings in which the Court analyzed in depth each argument invoked by one bank. These arguments were relying on views expressed by leading scholars and were raised by the banks to justify the retention of the money deposited in their accounts.

Initially, the bank sustained that giving the money back to the client would constitute a violation of foreign law (here, French criminal law) and should therefore qualify as a **subsequent impossibility of performance in accordance with Article 119 of the Swiss Code of Obligations (CO)**. Indeed, the bank put forth that, on the basis of changed circumstances for which the bank was not responsible, it could not perform its service, that is to say return the money to the client. According to the bank, the return of the money would constitute a complicity of tax fraud and money laundering pursuant to French criminal law. Such breach of foreign law would be contrary to the provisions contained in Swiss banking law, especially the "*Principle of irreproachable activity*".

On this point, the Court of First Instance of the Canton of Geneva ruled that, since the date of the opening of the bank accounts, there had been no material changes either in Swiss banking law or in the Swiss financial market regulations issued by the Swiss Financial Market Supervisory Authority (FINMA). Similarly, a possible infringement of French criminal law would already have occurred when the bank accepted, held and managed during several years the amounts of money in question. The Court noted that the *FINMA position paper on risks in cross-border financial services of 2010* constituted only "*the reflection of a growing awareness*" from the Swiss banks, which have now understood that they could face criminal proceedings in relation to undeclared funds that foreign citizens could hold in their accounts.

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[8] Federal Courts Judgments of 28th October 2015, 4A_168/2015 and 4A/170/2015.
[9] Cantonal Supreme Court of Zürich, ZR 114/2015 S. 49

Thus, the Court considered that there was no subsequent impossibility of performance pursuant to Article 119 CO.

Secondly, the bank attempted to rely on **its Terms and Conditions** under which the bank may refuse certain "*operations*". This would enable the bank to refuse the transfer of funds, except if the client were able to demonstrate that these funds were tax compliant.

In this regard, the Court held that the return of the assets is the primary obligation of a contract of deposit. This implies that the return of the money could not be understood as a simple "*operation*".

Therefore, the Court concluded that the bank could not rely on its Terms and Conditions in order to refuse the return of the money.

As a last resort, the bank attempted to rely **on Article 19 of the Federal Act of 18 December 1987 on International Private Law (IPLA) by contending that the return of the money to the client would go against the foreign public order**.

In this instance, the Court recalled that the Article 18 IPLA applies only in exceptional circumstances, i.e. when there are legitimate and manifestly predominant interests at stake. In such a case, a mandatory provision of a foreign law may be taken into consideration.

Regarding the present case, the Court determined that French criminal and tax law could not be applied to the contractual relationship between the parties. The court was aware that possible violations of such law would have already been committed at the beginning of the contractual relationship and have continued for years. Likewise, it would be illogical and unsatisfactory to apply Article 19 IPLA in the framework of a long-term contractual relationship.

For all these reasons, the Court ruled that the bank has no valid objection and must consequently return the assets to the client.

Concluding considerations

It should be noted that these rulings have been rendered by a Court of first instance. They should not be treated as definitive case law, as they were not decisions of the Federal Supreme Court. Furthermore, they are not enforceable yet because the bank appealed against them. It is therefore necessary to wait a few months in order to see whether the Cantonal Supreme Court and maybe eventually the Federal Supreme Court will confirm the reasoning of the lower Court.

Nevertheless, these rulings are very interesting, because it is the first time that a court has ruled on the merits of these issues and also because the reasoning of the Court is well motivated and convincing. We are of the opinion that this reasoning will likely be confirmed by higher Courts.

It may be possible that the banks which are ready to go to court regarding this particular type of matter, are doing so not in order to win legally (because they know that it will be difficult), but in order to demonstrate that they have taken all possible steps to respect (at this stage) the legislation of foreign countries and that they were obliged to give back the money held in their accounts because they had to comply with a judicial decision.

United Kingdom

High Court provides further guidance as to the recoverability of costs in trust proceedings

by Karen Boughton and Louise Oakley (London)

In the case of *Blades v Isaac* [2016] EWHC 601 (Ch)

The High Court in England has recently handed down a judgment on costs in trust proceedings that will be of interest to both beneficiaries and trustees. Although ultimately a decision about the costs of a claim for disclosure of information brought by a beneficiary against a trustee, the judgment provides a useful analysis of the CPR rules and case law on costs in a trust dispute. In particular, the decision provides some reassurance to trustees that the Court will be slow to remove a trustee's indemnity as to costs, and is only willing to do so in circumstances where the trustee has caused a loss to the trust fund. A breach of duty, provided the trustee acted reasonably, will not deprive a trustee of their indemnity, even if the Court finds against them.

Background facts

The testatrix died in June 2013 and was survived by her two daughters: Mrs. Blades, the claimant, and Mrs. Binder, her sister. The testatrix's will gave her whole estate (c.£900,000) to solicitor trustees to hold on a discretionary trust. The claimant, her husband, her children and the testatrix's cleaner were within the class of beneficiaries. Mrs. Binder was not. However, in a separate letter of wishes, the testatrix indicated a desire that Mrs. Binder receive 5 percent of the value of the estate and the trustees accordingly exercised their power under the trust deed to add Mrs. Binder to the class of beneficiaries.

The trustees made various distributions from the will trust to all of the beneficiaries (except Mrs. Binder) to a value of just over GBP500,000 between October 2014 and May 2015. Shortly following that Mrs. Blades instructed solicitors who repeatedly asked the trustees for disclosure of the estate and trust accounts.

The trustees refused to provide the accounts due to concerns about the effect such disclosure would have on the relationship between Mrs. Blades and her sister, in light of the history of discord between them. The trustees offered to disclose the accounts to a third party law firm for the purposes of advice to be sought in relation to anything that might give rise to a legitimate concern within the accounts, however Mrs. Blades rejected this offer and continued to pursue direct disclosure of the accounts.

In June 2015, the trustees obtained counsel's opinion that their stance on disclosure was correct. Mrs. Blades requested sight of counsel's opinion and the trustees refused to provide it on the basis of legal professional privilege.

In July 2015, the trustees indicated that if Mrs. Blades continued to disagree with their position they would apply to court for directions pursuant to CPR Part 64.

In September 2015, Mrs. Blades issued proceedings seeking an order to obtain the accounts of the will trust on the basis of a "*hostile*" claim under the third category of *Re Buckton*[10] in order that the normal principles of awarding costs in hostile litigations should apply, i.e. that the losing party would be responsible for paying the costs without recourse to the assets of the trust.

[10] [1907] 2 Ch 406

The Proceedings

At a directions hearing in November 2015, the trustees' counsel argued that the proceedings were in substance an application for directions by the trustees pursuant to CPR Part 64 and that Mrs. Binder should be joined as a party. Counsel for Mrs. Blades submitted that, following *Schmidt v Rosewood*[11], this was a straightforward dispute between the parties as to whether the trustees had correctly exercised their powers by refusing to disclose any accounts to Mrs. Blades. Master Matthews found in favour of the trustees.

In January 2016, after considering Master Matthews' comments and having sought a second opinion from alternative counsel, the trustees provided Mrs. Blades with the estate accounts.

Mrs. Blades sought an order that the trustees pay the costs of the proceeding personally and without resource to the trust or estate. The trustees sought an order that all parties' costs be paid out of the trust fund.

The decision

Trust documents

Counsel's opinion obtained by the trustees was not subject to legal professional privilege. There could be no legal professional privilege to prevent disclosure of information by trustees to beneficiaries. The opinion had been obtained for the benefit of the trust, was (properly) paid for by trust assets and was therefore a trust document that could be disclosed to beneficiaries if the court decided that this was necessary.

Costs

The court decided that the trustees should be paid from the trust fund on the indemnity basis as if this were a case in the <u>second</u> category of *Re Buckton*.

The important distinction made in *Lewin on Trusts* was referred to, i.e. between "*(i) cases of claims of breach of trust by trustees causing loss to the trust fund, and (ii) cases of claims that the trustees are in breach of some other duty, not itself causing loss to the trust fund*"[12] . In the present case, although the trustees may have breached their duty to account to the beneficiaries by failing to provide information, this had not caused a loss to the trust and therefore did not invalidate their right of indemnity. Moreover, the Court considered it of importance that: (i) the trustees did what they thought was right, acted in a reasonable manner and there was neither inexcusable delay or misconduct on the part of the trustees; and (ii) the claimant's solicitors had been unduly hasty in issuing proceedings.

Hostile claims

In response to Mrs. Blades' arguments that costs should be treated as though the case fell into category three of Re Buckton, Master Matthews drew a parallel with the case of *Des Pallieres v JP Morgan Chase & Co*[13] in that it was more, "*a disagreement… between a beneficiary and a fiduciary as to what the fiduciary's duties require, and whether the court is asked to resolve that disagreement on an application… invoking is supervisory powers.*" It was acknowledged that an application could (as indicated by the trustees) have been brought by the trustees to determine the issues in dispute between the parties and had they done so, the costs of the proceedings would have been met by the trust fund. Parallels in judicial approach can be drawn between this case and the Bermudian case of *Trustee L and others*[14], the ruling for which was handed down just three days later. In the Bermudian case, the court found that despite the defendants "*vigorously opposing*" the trustees' application for *Beddoe* relief, their

[11] [2003] UKPC 26
[12] Paragraph 74 of Master Matthews' judgment
[13] [2013] JCA146
[14] 2013 no 238

conduct was not sufficient to convert the case from Buckton category one to Buckton category three. Accordingly, their costs for opposing the *Beddoe* application were to be paid out of the estate on an indemnity basis.

Importance for trustees and beneficiaries

This case provides a useful analysis of the CPR rules and case law on costs in trust disputes and a timely reminder that this interaction is complex. Whilst the decision will be of comfort to trustees who seek counsel's opinion before acting, even where that opinion turns out to be wrong, trustees should also be mindful of the context in which they seek advice and the resultant effect this has on whether or not privilege can be claimed against the beneficiaries.

Legal Developments

Argentina

Details of the tax amnesty

by Martin Barreiro, Juan Pablo Menna and Fernando Goldaracena (Buenos Aires)

On 21 July 2016 the Plan was promulgated and on 22 July 2016 it was published in the Official Gazette.

The following is a summary of the Plan:

1. Beneficiaries of the Plan

The Plan shall be applicable:

To individuals with domicile or residence in Argentina as of 31 December 2015, with respect to unreported pre-existing assets held as of the date of promulgation of the Plan by the Executive Branch.

To legal entities, foundations, "fideicomisos" and funds registered in Argentina as of 31 December 2015, with respect to unreported assets held in the last fiscal year closed before 1 January 2016.

For purposes of the Plan, "Pre-existing Date of the Assets" shall be the above mentioned dates as they may correspond to (i) individuals with domicile or residence in Argentina; and (ii) legal entities, foundations, "fideicomisos" and funds registered in Argentina.

2. Deadline of the Plan

Benefits under the Plan can be applied for until 31 March 2017.

3. Exclusion of the Plan

The Plan shall not apply to assets held in jurisdictions identified by FATF as high-risk and non-cooperative jurisdictions.

Any individual who has been convicted of any criminal tax offense, or any other crime directly or indirectly related to any tax obligation, shall not be able to benefit from the Plan. Moreover, if any of the individuals who have been convicted of any tax offense were directors, officers or held any other similar position in a corporation, such corporation shall also not be able to benefit from the said Plan.

On the other hand, the participation of any individual and/or corporation currently subject to criminal proceedings for certain types of criminal offenses, such as money laundering, fraud, unlawful financial intermediation, etc., would be conditional on the result of such proceedings.

4. Regularization cost of the unreported assets

The regularization cost will be determined depending on when the assets will be reported and where they will ultimately be located, namely:

(i) assets located in Argentina and abroad (excluding real estate) regularized after 1 January 2017 and before 31 March 2017: 15 percent

(ii) assets located in Argentina and abroad (excluding real estate) regularized any time before 31 March 2017: 10 percent if the payment of the regularization cost is made with Public Bonds "BONAR 17" and/or "GLOBAL 17".

(iii) assets located in Argentina and abroad (excluding real estate) regularized before 31 December 2016: 10 percent

(iv) real estate located in Argentina and abroad: 5 percent

(v) assets located in Argentina and abroad for a value greater than ARS305,000 (approximately, USD21,000) but lower than ARS800,000 (approximately, USD55,000): 5 percent

(vi) assets located in Argentina and abroad for a value lower than ARS305,000 (approximately, USD21,000): 0 percent

(vii) funds located in Argentina and abroad regularized before 30 September 2016: 0 percent if the unreported funds are used to subscribe for a non-transferable/non-negotiable Public Bond to be issued on or before 30 September 2016 in US dollars (a) with a maturity date in 3 years, and (b) with no interest payment.

(viii) funds located in Argentina and abroad regularized before 31 December 2016: 0 percent if the unreported funds are used to subscribe for a Public Bond [non-transferable/non-negotiable during the first 4 years] to be issued on or before 31 December 2016 in US dollars (a) with a maturity date in 7 years, (b) with a 1 percent interest payment, and (c) with the benefit to exempt from the regularization cost an amount equivalent to 3 times the amount used for the subscription of the Public Bond.

(ix) funds located in Argentina and abroad regularized any time before 31 March 2017: 0 percent if the unreported funds are used to subscribe for/acquire quotas in Argentine mutual funds to invest in instruments for the financing of: (a) infrastructure projects, (b) production projects, (c) real estate projects, (d) renewable energy projects, (e) small and medium size companies, (f) mortgages, and (g) regional economies. These investments must be kept for a minimum period of 5 years.

(x) funds deposited in Argentine or non-Argentine financial entities during the 3 months prior to the "Pre-existing Date of the Assets" as long as (a) they were used to acquire real estate or movable assets located in Argentina or abroad, or; (b) they were used as capital of enterprises, or; (c) they were lent to income taxpayers domiciled in Argentina. In any of the above mentioned cases, the investment must be maintained for a period not less than 6 months or up to 31 March 2017, whichever is the longest. The cost of regularization of these funds shall be 10 percent if the regularization takes place before 31 December 2016, or; 15 percent if the regularization takes place after 1 January 2017 and before 31 March 2017.

5. Benefits of the Plan

The regularization implies the forgiveness of taxes not paid in previous fiscal years.

The regularization also includes a general criminal amnesty for tax, exchange control and customs crimes committed by the individuals and/or companies that voluntarily disclose their assets.

The regularization shall be valid even when the assets are registered in the name of the taxpayer´s spouse, or of any of the taxpayer´s ascendants or descendants in the first or second degree of consanguinity or affinity, or of any other Argentine third party. This benefit will apply only if the reported assets are in the name of the owner on or before the deadline to file the tax returns corresponding to fiscal year 2017.

With respect to non-Argentine legal entities, non-Argentine trusts, non-Argentine foundations, non-Argentine associations, or any other non-Argentine entity the owners or beneficiaries of which are Argentine persons entitled to the benefits of the Plan: such Argentine owners or beneficiaries will be entitled to report in their name the underlying unreported assets as long as such assets were owned by any of the above mentioned vehicles as of 31 December 2015.

6. Requirements of the Plan

The following are the requirements to make a disclosure of assets:

a. Filing an affidavit evidencing the holding of funds/shares/bonds or the like in a foreign country.

A bank statement or the like sent by mail or electronically by the foreign entity must specify:

1. name and domicile of the foreign entity;
2. number of the account;
3. name and domicile of the owner of the account;
4. evidence that the account was opened before the "Pre-existing Date of the Assets";
5. amount of the account in foreign currency as of the "Pre-existing Date of the Assets"; and
6. place and date of the issuance of the statement.

b. Filing an affidavit and transferring the funds/shares/bonds or the like to Argentine entities and depositing them in the name of the owner.

The receiving Argentine entity shall issue a certificate stating:

1. name and domicile of the owner of the account;
2. identification and domicile of the foreign entity;
3. amount of the transfer in foreign currency; and
4. place and date of the transfer.

c. Filing an affidavit for the disclosure of other assets;

d. Filing an affidavit and depositing the funds held in cash on or before 31 October 2016, in the name of the owner with Argentine financial entities for a period of not less than 6 months or up to 31 March 2017, whichever is the longest. These funds could be used before the expiration of the period of 6 months only to acquire real estate or movable assets.

The Plan does not exempt financial entities or other individuals from their obligations under the Anti-Money Laundering and Terrorism Financing laws.

* * * * *

On 28 July 2016, Decree N° 895/2016 was published in the Official Gazette and on 29 July 2016, General Resolution N° 3919 of the Federal Tax Authority and General Resolution N° 672/2016 of the National Security Commission were published in the Official Gazette, regulating the implementation of the Plan. Moreover, on 5 August 2016, Resolution N° 3-E/2016 of the Finance Secretary and the Treasury Secretary that regulates the issuance and subscription of the Bonds contemplated in the Plan, was published in the Official Gazette.

As from 1 August 2016 and until 31 March 2017, taxpayers will be able to disclosure unreported assets and request the benefits of the Plan.

As from 8 August 2016, taxpayers have been able to make offers to subscribe for the Bonds.

The regulations of the Exchange Commission regarding the subscription of the quotas of the Common Investment Funds to be created under the Plan, are pending publication.

Brazil

Inclusion of Dutch Holding Companies on the Brazilian privileged tax regime list

by Maria Furtado (Rio de Janeiro)

In March this year, the Brazilian Government responded to the Dutch authorities about the inclusion of Dutch Holding Companies within the Brazilian privileged tax regime list.

The relevant letter clarifies the following aspects:

1. Motif: according to the Brazilian IRS, the Dutch Income Tax legislation exempts dividends and capital gains in a variety of situations, allowing, to some extent, taxpayers to create structures without economic substance. As a result of such structures, a Dutch holding, without economic substance, might achieve taxation at levels significantly below the Brazilian tax burden.

2. The Concept of Substantive Economic Activity: a legal entity has substantive economic activity whenever it has, at its country of domicile, a structure consistent with the economic activity that it performs. In this context, structure means the legal entity's operational capacity, its premises, the number of qualified employees compatible with the relevant business. An adequate structure would be the one required for the development of the economic activities with the goal of generating revenues from the employed assets. In the case of holding companies, besides the structure required for the management of equity participation aiming at achieving income derived from profits' distribution and capital gains, the existence of substantive economic activity must be verified at each legal entity in which the holding company holds an interest. Such verification aims at assessing if the Group's corporate structure was being used as a mechanism to substantially reduce or eliminate Brazilian taxation. Accordingly, the interpretation of substantive economic activity must be based on an analysis of the economic group as a means to guarantee that the Dutch entity qualifying for the exemption is not functioning only, and or mainly, as an instrument to reduce taxation.

More recently, the Brazilian IRS released, for public consultation, the draft of a normative ruling clarifying the concept of substantive economic activity. This draft, which is consistent with the answer given by the Brazilian Government to the Dutch authorities, is still under analysis. The idea, however, is to enable Brazilian taxpayers to identify when a holding company should be deemed a privileged tax regime or not. To this extent, it states, according to its current draft wording, that a holding company would fall out of the privileged regime concept if it has, at its country of domicile, a structure (i.e., operational capacity and installations) fit to manage and effectively decide on the (i) the development of business activities resulting from its assets, other than dividends and capital gains and (ii) the equity participation it holds aiming at obtaining dividends and capital gains.

The draft normative ruling suggests that the Brazilian IRS will scrutinize the activities performed at the subsidiaries' level, as well as the effective influence performed by holding companies over their subsidiaries' business decisions.

New rules regarding the disclosure of a legal entity's corporate chain up to the individual deemed as its final beneficiary

by Maria Furtado and Rodrigo Vianna (Rio de Janeiro)

On May 2016, the Brazilian IRS enacted Normative Ruling # 1,634/16, amending the procedures currently governing the Brazilian General Taxpayers Registry ("CNPJ"). The main purpose of the new regulation is to enhance transparency of legal entities doing business in Brazil and, thus, enrolled with the CNPJ. The new rule also aims at preventing corruption and money laundering acts.

Among other provisions, the relevant Normative Ruling provided that Brazilian entities and certain foreign residents, including but not limited to those holding shares/quotas in a Brazilian entity, investing on the Brazilian capital gains and financial markets and/or chartering vessels to Brazilian customers, will be required to amend their CNPJ registrations to provide the Brazilian tax authorities with information on (i) the individuals authorized to represent them in Brazil and also on (ii) the relevant corporate chain, including trusts and foundations, up to the individuals deemed as their "final beneficiaries".

The concept of "final beneficiary", under the new CNPJ regulation, was defined as: (i) the individual(s) who either, directly or indirectly, owns, controls or significantly influences the legal entity; or (ii) the individual under whose name a given transaction is performed.

Exception is made for Brazilian corporations ("sociedades anônimas") or foreign listed entities incorporated in countries which require public disclosure of all relevant shareholders and which do not fall under the concept of low-tax jurisdiction or privileged tax regime. Exception is also made for other listed entities or CNPJ holders, such as non-profit organizations, private pension entities, pension funds, multilateral organizations, central banks, Brazilian investment funds ruled by the Brazilian Stock Exchange Commission, provided that some specific requirements are met.

For non-CNPJ holders the above information will be mandatory as from 1 January 2017. Whereas, legal entities which are already enrolled with the CNPJ registry, will be required to provide such information at their first CNPJ's amendment after 1 January 2017 but, in no event, later than 31 December 2018.

Failure to comply with the above-referenced requirements may cause the suspension of the CNPJ registry of the relevant legal entity, impairing the performance of banking transactions (e.g. operating bank accounts, performing financial investments, obtaining loans and/or remitting funds abroad).

Nevertheless, Normative Ruling 1,634/16 does not address the possibility that the CNPJ holder does not have final beneficiary information readily available. In effect, only CNPJ holders expressly waived from the obligation to disclose the final beneficiary information, together with foreign entities investing in the Brazilian capital and financial markets and subject to registration at the Brazilian stock exchange commission ("Comissão de Valores Mobiliários – CVM"), are allowed to check, within the Brazilian IRS system, the box of "non-required information".

As the individual appointed by the CNPJ holder to represent it before Brazilian IRS will be liable for any failure to comply with the above-referenced obligation, we anticipate that some financial institutions, acting as foreign residents' representatives with respect to their investments in the Brazilian financial and capital markets, may refrain opening new investment accounts and/or impose additional restrictions on the existing ones if the foreign investor does not provide it with the information required by Normative Ruling RFB # 1,634/16.

Although the Brazilian tax authorities' initiative to increase transparency should be praised, we understand that Normative Ruling RFB # 1,634/15 failed to address some situations where, in the lack of money laundering and/or corruption evidence, CNPJ holders should be able to provide information of their listed direct or indirect holders, regardless of such holders' domicile or qualification as a privileged tax regime.

Finally, note that, from a Brazilian perspective, the imposition of penalties, such as the ones provided by Normative Ruling RFB # 1,634/15, must be governed by legislation rather than by a mere normative ruling.

Chile

Chilean corporate tax changes

by Alberto Maturana, Sergio Illanes, Ignacio Gepp (Santiago)

With only 3 months left for the end of 2016, Chilean taxpayers and foreign investors with interests in Chile are adopting tax and corporate decisions and executing internal reorganizations, in light of the substantial changes to the Chilean tax system that will enter into force on 1 January 2017.

Among the many issues that require preparation, the most noticeable are the following:

I. Election of a suitable corporate tax system

Subject to eligibility requirements, Chilean corporate taxpayers may be able to elect, until 31 December 2016 between an integrated or semi integrated corporate tax system. The election is binding for 5 years.

The integrated tax system will imply that the corporate taxpayer will be taxed on accrued basis, at a 25 percent corporate tax whereas its shareholders will be taxed within the same period, at a capped 35 percent tax rate on the profits attributable to them. Against the shareholders tax (surtax or withholding tax), 100 percent of the corporate tax paid by the corporate taxpayer will be creditable, thus resulting in an overall taxation no higher than 35 percent[15].

In opposition to the above, the semi integrated corporate tax system will cause the corporate taxpayer to be taxed at a higher corporate tax (25.5 percent during 2017 and 27 percent from 2018 onwards) whereas its shareholders will be taxed on effectively distributed dividends at a capped 35 percent tax rate. Nevertheless, only 65 percent of the corporate tax paid by the corporate taxpayer will be creditable against the shareholders tax (surtax or withholding tax, depending on where the shareholder resides), thus resulting in an overall tax burden as high as 44.45 percent.

Notwithstanding the aforementioned, foreign investors residing in treaty countries[16] with interest on a corporate taxpayer subject to the semi integrated corporate tax system will be able to claim a full credit for the corporate tax paid by the corporate taxpayer against their withholding tax on dividends, thus resulting in an overall taxation of 35 percent. Thus, Chilean enterprises held by foreign treaty resident shareholders and subject to the so called semi integrated corporate tax system, will preserve the full integration of corporate income taxes, and the ability to defer the second tier tax on effective dividend distributions.

II. Election of a suitable holding jurisdiction

Due to the above, foreign investors may wish to consider domiciling holding vehicles of Chilean investments in one of the existing 26 countries with which Chile has a tax treaty in force[17]. If we add the treaties that are signed although not yet in force[18], the number of alternatives increases to 34.

[15] Chilean resident shareholders subject to surtax may benefit from an even lower overall tax burden.
[16] Until 31 December 2019, foreign investors residing in countries with which Chile has signed a tax treaty that is not yet in force (e.g. USA) will be treated as foreign investors residing in a treaty country. After said date, they will be treated as foreign investors of non treaty countries.
[17] Australia, Austria, Belgium, Brazil, Canada, Colombia, Croatia, Denmark, Ecuador, France, South Korea, Ireland, Malaysia, Mexico, New Zealand, Paraguay, Peru, Poland, Russia, Spain, Sweden, Switzerland, Thailand and the United Kingdom.
[18] Argentina, China, Czech Republic, Italy, Japan, South Africa, USA and Uruguay.

Furthermore, until 31 December 2016, capital gains arising from the sale of Chilean shares may be subject to corporate tax (24 percent) as a sole lien if the investment has been held for more than a year.

From 2017 onwards capital gains generated on the sale of Chilean shares will be subject to a 35 percent withholding on the hands of foreign shareholders, regardless of the holding period of their investment. In certain cases, treaty limits on capital gains may become significant.

Furthermore, given the change in the capital gain taxation regime, it may be worth considering simplifying the ownership on Chilean operating entities by eliminating unnecessary holding tiers.

III. Election of whether or not to pay a reduced tax on accumulated tax profits

Finally, it is worth noting that corporate taxpayers have been given a window of opportunity, until April 2017, by which they are allowed to pay a reduced 32 percent tax (instead of the general 35 percent, applicable today) on all or part of their tax retained earnings, against which they are entitled to use 100 percent of the corporate tax credit associated to said profits.

Once the tax is paid, tax retained earnings will turn into non taxable profits, which can be distributed to the shareholders at any time regardless of the existing imputation orders as established in the Chilean Income Tax Law. This regime is already being used by local companies to establish (and anticipate the taxation on) their Dividend Policy for the next few years.

Individuals residing in Chile with direct ownership over the corporate taxpayer may even benefit from a lower tax burden.

IV. Vesting of awards during 2016

For the remaining of 2016, awards (stock options, RSUs, etc.) will not be typically subject to employment taxation on vesting or exercise (with the exception of certain RSUs).

However, from 2017 onwards, certain specific awards vested on, or exercised by, executives and/or board members will be subject to taxation assessed on the fair market value of the award.

Therefore, multinational groups may wish to consider accelerating the grant or vesting of certain awards during 2016, the review and adoption of possible adjustments to existing Long Term Incentive Plans; and getting tax advice on new awards to be granted from 2017 on.

Chilean IRS to audit taxpayers that failed to comply with BEPS inspired tax filing

On 1 September 2016, the Chilean IRS announced it intends to progressively audit 4,288 taxpayers that failed to comply with filing IRS Form No. 1913.

Form No. 1913 is a BEPS inspired information return by virtue of which large taxpayers are required to report a number of operations that may have been tax driven, among which the following are specifically mentioned: corporate reorganizations, use of derivatives and financial instruments, percentage of EBITDA used to pay for interest, royalties, management fees and others alike benefiting related parties.

This information return was to be filed along with IRS Form No. 22 (i.e. Chile's annual income tax return) and although failing to comply with it was only subject to a penalty of approximately USD800, the IRS position is to start audit reviews on taxpayers that remain uncompliant.

Colombia

The expected tax reform

by Rodrigo Castillo (Bogota)

It is expected that the Government will file before Congress the structural tax reform bill in October. The scope and text of tax reform remains unknowns and up to now only the recommendations provided by the committee of tax experts are available and those are not binding on the Government or Congress. However, it has been said by public officials that the tax reform would have four pillars:

1. To unify income tax and income tax on fairness (CREE) and to create a sole tax on profits and possibly, a tax on dividends;

2. Tackle the abuse of non-profit organizations not having a philanthropic destination and used for tax evasion purposes;

3. To implement more anti-avoidance measures;

4. To definitively phase out the wealth tax.

In the context of an upcoming peace referendum and with the expectation of attracting more inbound investments, the tax reforms seem to be imminent.

France

Non disclosure of bank accounts/portfolios held outside France by French tax residents: the 5 percent penalty ruled unconstitutional

by Hervé Quéré and Malvina Puzenat (Paris)

French Constitutional Court, decision n°2016-554 QPC, July 22, 2016

The French Constitutional Court ruled that the 5 percent penalty which may apply in case of failure to disclose offshore bank accounts/portfolios which total balance exceeds EUR50,000 as at 31 December of the concerned year is unconstitutional.

The Court referred to article 8 of the Declaration of Human and Civic Rights, 1789 according to which "*The law must prescribe only the punishments that are strictly and evidently necessary; and no one can be punished except by virtue of the law drawn up and promulgated before the offence is committed, and legally applied.*"

The Court had to determine whether there is no great disproportion between the infringement and the applicable above penalty. The 5 percent penalty only depends on the total balance of the undisclosed bank accounts/portfolios even if there is no tax evasion or fraud in relation with these accounts/portfolios. The Court considered consequently that a 5 percent rate applicable as a result of the non-compliance with a mere reporting obligation is disproportionate considering the aim being pursued.

In practice:

- As of the date of the decision, 22 July 2016, the 5 percent penalty cannot be applied anymore. The flat EUR1,500 or EUR10,000 will be applicable.

- For the past, the 5 percent penalty can be refunded within the statute of limitations.

- As regard to voluntary disclosure procedures with the French tax authorities:

    - For ongoing procedures i.e. when transactions have not yet been signed by the French tax authorities, the 5 percent penalty (reduced to 3 percent or 1.5 percent depending on the situation of the taxpayer) will not be applied. Only the flat EUR1,500 or EUR10,000 would be applied.

    - For the past i.e. when transactions have already been signed by the French tax authorities, the reduced 3 percent or 1.5 percent penalty may not be refunded. Indeed, the taxpayers had signed and accepted the terms and conditions of the transaction with the French tax authorities so that no refund may be claimed.

In the near future, the French legislator will certainly adopt a new proportional penalty, application of which will depend on whether a tax fraud or evasion may be characterized.

Further, it is possible that the 5 percent penalty and the 12.5 percent penalty applicable in case of failure to report respectively life insurance contracts and trusts would be also viewed as unconstitutional for the same reasons and be applicable only in case of tax fraud or evasion.

Germany

Full tax exemption from German inheritance and gift tax for gratuitous transfer of work of art

by Sonja Klein and Ludmilla Maurer (Frankfurt)

With its decision dated 12 May 2016, the Federal Fiscal Court outlined the requirements for qualifying for exemption from German inheritance and gift tax upon gratuitous transfers of works of art. This decision provides clear guidance for structuring a tax-free transfer of such assets by way of donation or inheritance.

Statutory inheritance and gift tax exemption rules applicable to gratuitous transfer of works of art

Under the German Inheritance and Gift Tax Act, the gratuitous transfer of works of art and art collections by way of inheritance or donation is exempt from German inheritance and gift tax up to 60 percent of their value under the following preconditions:

(i) the preservation of such works is in the public interest because of their importance for art, history or science,

(ii) yearly expenses related to such works regularly exceed the incurred income, and

(iii) the works are or will be accessible and utilized for research or national education purposes - to the extent appropriate.

Moreover, such acquisition of works of art is fully tax exempt provided:

(a) the requirements as stated above under (i) to (iii) are met,

(b) the taxpayer is willing to make the works subject to applicable law on preservation of historical monuments, and

(c) the relevant objects are in the possession of the family for at least 20 years or are included in the register of cultural property of national significance or archives of national significance pursuant to the Act for the Protection of German Cultural Heritage against Removal.

The tax exemptions lapse with retroactive effect if the acquired objects are disposed of within 10 years upon their acquisition or the requirements for the respective tax exemption as stated above lapse within this timeframe.

The same rules apply with respect to the gratuitous transfer of scientific collections, libraries, archives and real estate or parts of real estate whereby the partial tax exemption of real estate or of its parts amounts to 85 percent of its value.

Decision of the Federal Fiscal Court

In its recent decision, the Federal Fiscal Court ruled that on the criteria for determining the taxpayer's willingness to make the acquired objects subject to the applicable law on the preservation of historical monuments (as stated above under (b)) as all other criteria for a full tax exemption were given. The relevant taxpayer in this respect is the transferee. The Court pointed out that the "willingness" is a subjective element. Whether or not this requirement is met must be assessed based on objective facts, and indications. For example, an indication of such willingness is the notification of the responsible authority for the preservation of historical monuments, statement of appropriate conservation of objects, beginning of maintenance or restoration work or the conclusion of a loan and cooperation agreement with a relevant museum. A sovereign measure, e. g. the inclusion of objects in the register of cultural property of national significance, is also sufficient, but not required. Furthermore, the Court ruled that such measures indicating the required willingness of the taxpayer must be taken in due course upon the acquisition of such objects whereby a time period of six months is typically still appropriate.

In the case at hand, the taxpayer concluded a loan and cooperation agreement with a foundation that exhibits work of art in a museum. The taxpayer remained in the possession of the art collection, but granted the foundation the right to access the art collection at any time. The foundation was eligible to analyze the art collection for scientific purposes. The loan and cooperation agreement had a fixed term of 10 years with an option to extend the contractual period for another five years. The Court held the conclusion of such loan and cooperation agreement as being sufficient and assumed that the relevant museum that is granted such right of access will make use of its right.

Furthermore, the Court ruled that, with respect to an art collection, every single work of art must be in the possession of the family since at least 20 years. If some objects do not meet this requirement, such objects can only be partly tax exempt at 60 percent of their value. However, the remaining part of the collection can still benefit from the full tax exemption.

Finally, the Court ruled that if one single piece of art of the collection is sold during the 10 years upon its acquisition, the tax exemption lapses with retroactive effect only with respect to this individual object and not with respect to the entire collection.

Consequences for the taxpayer

The recent decision of the Federal Fiscal Court provides for more clarity with respect to the preconditions for benefitting from existing inheritance and gift tax exemptions for works of art. Transferees receiving works of art or an entire art collection by way of donation or inheritance may

consider making these works subject to the applicable law on preservation of historical monuments in order to qualify for the full exemption from German inheritance and gift tax provided, however, the other requirements as stated above are also met. Otherwise, a German inheritance and gift tax exemption of up to 60 percent may apply. Due to the time restraints for evidencing the willingness to make the works of art subject to the law on preservation of historical monuments, a proper and timely planning of the respective measures to be taken is required.

The same considerations apply with respect to the gratuitous transfer of scientific collections, libraries, archives and real estate or parts of real estate..

Non-recognition of a foundation for preservation and promotion of art work as non-profit entity for German tax purposes

by Sonja Klein and Ludmilla Maurer (Frankfurt)

With its recent decision dated 24 May 2016, the Federal Fiscal Court ruled that a foundation set up to preserve and promote art work does not qualify as a non-profit entity for German tax purposes if the activity of the foundation is carried out predominately in the founder's interest.

General rules applicable to non-profit foundations

Under German tax law, foundations and other organizations qualifying as non-profit entities for German tax purposes are generally exempt from income as well as from gift and inheritance tax. Thus, such foundations are not subject to German corporate income and trade tax and can receive donations or inheritances tax-free. However, the non-profit character of the foundation must be determined and confirmed by the responsible tax office for qualifying for the tax exemptions.

Under German tax law, an organization qualifies as a non-profit entity if, according to its articles of incorporation and its actual management, such organization serves exclusively and directly non-profit, charitable or churchly purposes. An organization serves non-profit purposes if its activities are aimed at supporting the public in a material, mental or ethical sense and in an altruistic, exclusive and immediate manner. Support is provided in an altruistic manner if the activities do not primarily pursue its own economic purposes. According to established case law of the Federal Fiscal Court, an organization pursues its own economic purposes if it carries out its activities in its own interest or in those of its founder or members.

Court decision

In the relevant case, the founder of the foundation gratuitously transferred his collection of art to the foundation established with the purpose to preserve and promote art work. However, because of the specific factual circumstances he remained in the possession of the collection and the foundation basically pursued his interests in the administration of the collection.

The Court decided that the activity of the foundation was not altruistic, but predominately in the founder's interest. After the incorporation of the foundation and upon the transfer of the collection to the foundation, neither the premises nor the administration of the collection were changed. Even after new premises were rented for preservation of the collection, the founder had full access to the collection at any time as before. Furthermore, the collection was not accessible to a large public but only a few pieces of the collection were occasionally lent for public exhibition. At any time even after the transfer, the founder was able to pursue his interest in administration of the collection in the same manner as before. Even though some pieces of art were occasionally lent for public exhibitions, the actual administration of the collection complied with the founder's interest to preserve and to expand the art collection according to his preferences. Thus, the activity of the foundation was not altruistic but predominately in the founder's interest.

Relevance for taxpayers

The decision was made in the course of a preliminary court procedure for obtaining suspension of implementation. The main proceedings before the Federal Fiscal Court are still pending but it would be rather surprising if the Court changes its initial evaluation.

The transfer of art work to a non-profit foundation is a popular tax planning tool, in particular for purposes of succession planning. However, the decided case illustrates that careful planning is required, in particular in relation to the founder's and his family's continuing interest in the collection, in order to ensure the contemplated tax result. It is in particular of importance to make sure that the requirements for the non-profit character of the foundation, including the altruistic activity of the foundation, are met and can be evidenced to the responsible tax authorities.

German rules regarding tax allowances for non-German tax residents for inheritance and gift tax purposes violate EU law

by Sonja Klein and Ludmilla Maurer (Frankfurt)

The European Court of Justice ("ECJ") ruled on 8 June 2016 (C 479/14) that the currently applicable German inheritance and gift tax rules regarding tax allowances for non-German tax residents constitute an unjustified restriction to the free movement of capital.

Current legal situation

Non-German taxpayers who receive German real estate or other German situs assets as a gift from or upon the death of another non-German resident are subject to German gift or inheritance tax with respect to those assets. However, in contrast to German resident beneficiaries who are entitled to a tax allowance of up to EUR500,000 depending on the degree of kinship to the transferor, non-German tax resident beneficiaries can only claim for a tax allowance of EUR2,000, irrespective of the degree of kinship. In the last few years, the ECJ had to give its verdict on related matters (case reference C 510/08 in 2010, C 181/12 in 2013 and C 211/13 in 2014). In all three relevant cases the ECJ decided that the respective provisions of the German Inheritance and Gift Tax Act violate the principle of free movement of capital. As a reaction to the first decision, the German legislature introduced the option for EU/EEA resident taxpayers of being taxed as German residents in order to benefit from the higher tax allowances. However, upon exercising the option, the total benefit received and not only the German situs assets would be subject to German tax. In case of substantial foreign assets in addition to the German situs assets in excess of the applicable allowance, the exercise of the option typically results in a high German tax liability with only very limited ability for a reduction by a credit for foreign tax. Furthermore, all benefits received from the same person within 10 years prior to the taxable event as well as all benefits received from the same person within 10 year after the taxable event would be deemed to be subject to resident taxation in Germany and summed up for determining the relevant German tax liability. In case of German resident beneficiaries, only the time period of 10 years prior to the taxable event is considered.

ECJ decision

In the case at hand, a UK resident transferred German real estate property by way of gift to her two UK resident daughters. The German tax authorities applied the tax allowance of EUR2,000 for each daughter, while the tax allowance applicable to transfers to children under German resident taxation rules amounts to EUR400,000. The mother applied for the higher tax allowance with respect to both transfers to her daughters without being obliged to opt for German resident taxation. After receipt of negative decisions at administrative level, she appealed the decision of the German tax authorities before the Fiscal Court Düsseldorf that referred the case to the ECJ.

In its decision, the ECJ confirmed the view of the referring Fiscal Court Düsseldorf that the currently applicable German rules regarding tax allowances to non-German residents for inheritance and gift tax purposes violate EU law. The application by the EU/EEA resident for being treated as German resident for inheritance and gift tax purposes in order to benefit from higher tax allowances implies the application of German resident taxation rules to all transfers within a total time period of 20 years (10 years prior and 10 years after the taxable event). In contrast hereto, in case of German resident beneficiaries, only the time period of 10 years prior to the taxable event is considered. Thus, with respect to non-German residents, the relevant time period is extended by additional 10 years so that concerned taxpayers do not know what additional gift or inheritance tax they might be subject to in the future. The lack of predictability can keep non-German residents from acquiring or retaining German situs assets. This constitutes a restriction of free movement of capital. The Court saw no reasons or justification for such different tax treatment.

Furthermore, the Court emphasized that the automatic application of the lower tax allowance and the requirement of an application by the non-German beneficiary to make the gift or inheritance received subject to German resident taxation in order to benefit from the higher tax allowance could by itself already violate the EU law.

Comments

As long as the German legislature has not revised the German rules regarding the tax allowances applicable to transfers to non-German residents for gift and inheritance tax purposes, non-German resident beneficiaries are advised to file the respective inheritance or gift tax return by applying for the higher tax allowances available to German resident beneficiaries by referring to the cited ECJ decision.

Furthermore, since the free movement of capital is also applicable to non-EU/EEA member countries, the cited ECJ decision should apply in the same manner with respect to non-EU/EEA resident beneficiaries as well.

Indonesia

Tax amnesty law: An opportunity for taxpayers to clean up their unsettled tax obligations

by Ponti Partogi, Ria Muhariastuti and Nalphian Seotang (Jakarta)

Recent Development

The Indonesian House of Representatives and the President passed Law No. 11 of 2016 on the Tax Amnesty on 28 June 2016. Up to early September 2016, the Minister of Finance and the Director General of Tax have issued several implementing regulations of the Tax Amnesty Law.

Implications for Taxpayers

The tax amnesty is a time limited opportunity for a specified group of taxpayers to pay a defined amount, in exchange for forgiveness of tax liabilities (including interest and penalties) relating to a previous tax period or periods and without fear of criminal prosecution. In Indonesia the defined amount to be paid is called a Redemption Charge.

The Redemption Charge is significantly lower than the amount of tax that would have been paid if the tax had been paid using the tax rates applicable when the income should have been reported. Currently, under the normal regime, individual taxpayers are subject to a progressive tax rate with a maximum rate of 30 percent, and corporate taxpayers are subject to a flat rate of 25 percent. The Redemption Charge

is calculated by multiplying the relevant rate by the amount of declared additional net assets. The following table summarizes the rates used to calculate the Redemption Charge.

Type of assets	Applicable rate in		
	Jul - Sep 2016	Oct - Dec 2016	Jan - Mar 2017
Offshore assets - not repatriated to Indonesia	4%	6%	10%
Offshore assets - repatriated to Indonesia and invested in Indonesia for a minimum of three years	2%	3%	5%
Onshore assets - retained in Indonesia for a minimum of three years	2%	3%	5%

Taxpayers whose annual turnover is not more than IDR4.8 billion in 2015 are entitled to a rate of 0.5 percent if the assets declared are not more than IDR10 billion, and a rate of 2 percent if the assets declared are more than IDR10 billion. These rates are applicable for all three types of assets and all three periods of time above.

Taxpayers who join the tax amnesty program will obtain benefits such as:

- a waiver of the tax due, administrative sanctions and criminal sanctions on the tax obligations in or prior to 2014 or 2015;
- exemption from tax audit, preliminary evidence tax audit and tax crime investigation for all tax obligations for fiscal years up to and including 2014 or 2015; and
- discontinuation of ongoing tax audits, preliminary evidence tax audits and tax crime investigations for all tax obligations for fiscal years up to and including 2014 or 2015.

As reported in the news, there will be amendments made to the tax laws (e.g., the General Tax Provision and Procedure Law, the Income Tax Law and the Value Added Tax Law) after the implementation of the tax amnesty. The era of exchange of information will start due to the Base Erosion and Profit Shifting action plan made by G20 countries. Indonesia has committed to participate in the exchange of information in 2018. Such exchanges of information will mean that the Indonesian tax authority will have more powers or sources of information to collect taxes.

Taxpayers who participate in the tax amnesty program would forfeit certain of their taxation rights including the right to use remaining tax losses carried forward, and to ask for a refund from the years up to and including 2014 or 2015. Also, if a taxpayer is in a dispute resolution process with the Director General of Tax, e.g., there is an ongoing tax objection process or tax appeal process, it has to revoke the claim related to the process and pay all the outstanding tax liabilities.

What the law says

We set out below some essential provisions under the latest draft law.

What is the scope of tax amnesty?

Even though the tax amnesty program should be more directly related to income tax obligations, the scope of this program also covers value added tax (*Pajak Pertambahan Nilai/PPN*) and luxury goods sales tax obligations (*Pajak Penjualan atas Barang Mewah/PPnBM*). It seems to us that this is aimed to encourage taxpayers to join this program provided that the amount of tax liability from value added tax and luxury goods sales tax obligation is significant as well.

Who is entitled to participate?

All taxpayers (individual and corporate taxpayers) are entitled to participate, except for those:

- whose tax crime investigation cases have been declared completed by the public prosecutor;
- that are undergoing court proceedings for a tax crime; and
- that are undergoing criminal sanctions due to a tax crime.

When to participate?

The deadline of the tax amnesty program is 31 March 2017. This will be divided into three periods, i.e. (i) July - September 2016, (ii) October - December 2016, and (iii) January - March 2017. These periods affect the amount of Redemption Charge to be paid. The quicker the taxpayers apply for the tax amnesty, the lower the amount of the Redemption Charge to be paid. (Please refer to the table on Redemption Charge rate above.)

How to participate?

In general, the following are the steps to participate in the tax amnesty program:

1. The taxpayers prepare a Declaration Letter and its attachments.
2. The taxpayers ask the tax office for an explanation on filing and completion of documents to be attached to the Declaration Letter.
3. The taxpayers pay the Redemption Charge and settle all outstanding tax liabilities.
4. The taxpayers submit the Declaration Letter and its attachments (including the evidence of the assets being disclosed).
5. The Director General of Tax issues a receipt.
6. The Minister of Finance issues the Notification Letter within 10 working days after the date of receipt. If the Minister of Finance does not issue the Notification Letter within 10 days, the Declaration Letter is deemed as the Notification letter.

The Declaration Letter is the letter that will be used by the taxpayers to apply for the tax amnesty. In this letter, the taxpayer, among other things, has to disclose all of its assets (including those that have not been reported in the latest tax return).

The Notification Letter is the letter issued by the Minister of Finance as evidence of the tax amnesty granted.

Actions to consider

In general, we believe this tax amnesty program is a good opportunity for taxpayers to regularize their tax affairs, and have a fresh start where they can be in compliance with their tax obligations. However, of course, the interests of each taxpayer may be different from one to another. Therefore, the specific interests of each taxpayer should also be taken into account before participating in this program.

It is prudent if taxpayers who want to participate in the tax amnesty program seek assistance from a licensed tax professional who understands the relevant regulations.

Mexico

Mexican tax developments - reporting obligations

by Jorge Narváez-Hasfura, Javier Ordonez-Namihira, Lizette Tellez-De la Vega and Lucero Sanchez-De la Concha (Mexico)

A recent tax amendment would affect, from a reporting perspective, the current standing of a number of off-shore structures held by Mexican residents. The amendment to the Mexican Administrative Guidelines ("Miscelanea Fiscal"), in force as of 15 July 2016, is triggered by what is being discussed among countries on tax transparency and in particular, by:

1. the conclusions reached at the 2016 London Anti-Corruption Summit where the need and mechanisms to identify the beneficial ownership of off-shore investments were discussed,

2. the Panama Papers phenomenon, and

3. the Mexican authorities concern of the US not participating in the exchange of tax information through the Common Reporting Standard.

As such, within the context of the current international environment fostering the transparency of international transactions to prevent tax evasion, corruption and money laundering, the Mexican tax authorities have taken one more step towards the disclosure of investments made abroad by Mexican residents by eliminating, as of 15 July 2016, the no-reporting exception available through the Administrative Tax Guidelines for:

1. direct and indirect investments maintained in blacklisted jurisdictions that have in force a Tax Information Exchange Agreement with Mexico; and

2. investments carried out in any jurisdiction through fiscally transparent entities.

This amendment requires Mexican residents maintaining during 2016 any kind of off-shore investment in blacklisted jurisdictions or through fiscally transparent entities to report their participation in these structures by filing the informative return on February 2017. Mexican residents are required to file this informative return, regardless of whether they retain or have relinquished control over the off-shore investment and does not automatically trigger the application of the Preferential Tax Regime Rules (PTR) regarding the income inclusion on accrual basis.

Which exceptions have been repealed as of 15 July 2016?

The Mexican Administrative Guidelines included some relevant exception rules regarding the application of PTR, mainly those related to the filing of annual informative returns in connection with non-PTR income derived by residents from offshore investments, either in black listed jurisdictions or through fiscally transparent entities.

The exceptions that applied in connection with Article 178 (2) of the Mexican Income Tax Law (MITL) and were repealed are as follows:

1. Investment located in a country with a recognized Tax Information Exchange Agreement (TIEA) despite its black listed status

The second paragraph of Rule 3.19.11. established that, for purposes of Article 178 (2) of the MITL and in connection with the black list contained under Transitory provision XLII of the 2014 MITL, taxpayers deriving non-PTR income from the expressly listed jurisdictions under Rule 2.1.2. as of the dates specified therein, may not file the annual informative return set forth under Article 178(2) of the MITL. Thus, Mexican taxpayers with investments located in any country having a TIEA in force with

Mexico recognized under Rule 2.1.2. were exempted from complying with the obligation to file annual informative returns –established under Article 178 (2) of the MITL- provided that their investments are not deemed subject to a PTR per se.

2. Indirect Investments in Blacklisted Jurisdictions

According to the former Rule 3.19.9, indirect investments made by Mexican taxpayers in blacklisted jurisdictions through entities located in non-blacklisted countries were not subject to the reporting requirements mentioned in Article 178 (2) of the MITL.

3. Fiscally Transparent Entities with Lack of Effective Control and TIEA in place

Under Rule 3.19.9., Mexican taxpayers that derive income through fiscally transparent entities incorporated in a jurisdiction with a TIEA in effect with Mexico, were not liable to file annual informative returns, provided that no effective control existed over the investment and to the extent that such TIEA is duly recognized as such under Rule 2.1.2.

Saudi Arabia

Foreign Investment

by George Sayen, Karim Nassar (Riyadh) and Zahi Younes (Dubai)

The Saudi Arabian authorities have issued a new law allowing for 100 percent foreign owned investments in the trading sector in the Kingdom subject to certain requirements.

Foreign investment in a trading activity in Saudi Arabia is now open to companies having a presence in at least three markets. The new regulations require that the local company must:

1. have a capital of at least SAR30 million at the time of its incorporation (USD8 million);
2. invest in Saudi Arabia no less than SAR200 million (including the capital) over the first five years starting from the date of its incorporation (USD53 million);
3. commit to the employment of Saudi Arabian nationals as determined by the Ministry of Labor, and to develop and implement a plan for such employees to assume leadership positions in the company and ensure it's continuity;
4. train 30 percent of Saudi Arabian employees annually;
5. achieve one or more of the following during the first five years of the company's incorporation:
    (a) produce in Saudi Arabia 30 percent of the products it distributes therein;
    (b) allocate at least 5 percent of its total sales to establish R&D programs in the Kingdom; or
    (c) establish in Saudi Arabia a unified center to provide logistics and distribution services and post-sales support.

This is an interesting development for those interested in investing in Saudi Arabia.

Taiwan

New anti-avoidance rules

by Michael Wong, Andrew Lee and Tehsin Wu (Taipei)

In response to the global anti-avoidance sentiment brought by the OECD BEPS (Organization for Economic Co-operation and Development - Base Erosion and Profit Shifting) action plans and recent Panama Papers incident, earlier this year Taiwan's Ministry of Finance ("MOF") resumed its proposal to introduce the long awaited anti-avoidance rules through amendments to the Income Tax Act. On 28 April 2016, the Executive Yuan announced its finalized draft amendments to the Income Tax Act and presented it for legislation. On 12 July 2016, the amendments were passed by the Legislative Yuan, but the effective date has not yet been determined. According to the Legislative Yuan, the controlled foreign company ("CFC") and place of effective management ("PEM") rules are to take effect after the promulgation of the cross-Strait tax arrangements, implementation of common reporting and due diligence standards ("CRS"), and enactment of related regulations.

The new rules

1. Controlled Foreign Corporations

The CFC rules have been amended into Article 43-3 of the Income Tax Act, which requires a Taiwan corporate taxpayer to include in its taxable income its pro rata share of the taxable profits of its CFC. A CFC for the purposes of Article 43-3 of the Income Tax Act is defined as a corporation established in low tax territories that is more than 50 percent owned (directly or indirectly) or dominantly influenced by a Taiwan business entity. Exemptions apply when the CFC has actual business activities in the jurisdiction of its incorporation or its profits do not reach the threshold prescribed by the Taiwan tax authorities (which is not yet available). The adoption of CFC rules would eliminate the deferral of taxation on those overseas profits and would discourage businesses from leaving earnings in foreign jurisdictions.

It should be noted, however, that the CFC rules are only applicable to Taiwan corporate taxpayers. Individual taxpayers are not included in the current amendment. To avoid individual taxpayers bypassing the CFC rules by operating the CFC under his or her own name, in June 2016 the Executive Yuan proposed to amend the Income Basic Tax Act (the so-called Alternative Minimum Tax or "AMT" Act) to cover the individual taxpayers. According to the proposed AMT Act amendments, a Taiwan individual taxpayer shall include in his/her AMT the pro rata share of the taxable profits of his/her CFC, provided (i) the Taiwan individual taxpayer directly or indirectly owns 50 percent or more of the CFC shares, or (ii) the Taiwan individual taxpayer's shareholding in the CFC, when combined with his/her spouse and relatives within the second degree of kinship, reaches 10 percent or more of the CFC shares AND such Taiwan individual taxpayer has dominant influence on said CFC.

2. Place of Effective Management

The PEM rules have been amended into Article 43-4 of the Income Tax Act. Before the amendment, only companies incorporated under Taiwan laws will be subject to corporate income tax in Taiwan, and foreign companies will not be taxed in Taiwan unless they maintain a fixed place of business or business agent in Taiwan. With introduction of the PEM rules, foreign companies will be taxed in Taiwan if they are construed as having their place of effective management within Taiwan. According to Article 43-4 of the Income Tax Act, foreign companies will be deemed Taiwan tax residents if all of the following conditions are met:

2.1. Decision makers (individual and corporate) for significant operation management, financial management, and human resource management are residents in Taiwan or incorporated in Taiwan; or such decisions are made within the territory of Taiwan;

2.2. Creation and storage or financial statements, accounting records and shareholders/directors meeting minutes are within the territory of Taiwan; and

2.3. Main business activities are executed within Taiwan.

Possible impact on individual taxpayers in Taiwan who have offshore companies

1. Controlled Foreign Corporations

As the new CFC rules target on Taiwan companies having offshore CFCs, for now Taiwan individual taxpayers do not need to worry about the CFC implications. However, once the AMT amendments have been approved by the Legislative Yuan, the AMT liabilities for Taiwan individual taxpayer will be increased.

2. Place of Effective Management

This new rule is actually targeted at Taiwan citizens and companies who hold their portfolio through holding companies incorporated in tax havens such as the British Virgin Islands. Such holding companies have effectively shielded the taxpayers from Taiwan income tax without the PEM rules. However, when the new PEM rules come into the picture, Taiwan citizens and companies, as well as the wealth management industry that caters to them, will inevitably be impacted.

It is a common practice in the world of wealth management that trust assets are transferred to an offshore holding company under a trust arrangement and the settlor maintains the authority over decision making of the underlying company. Prior to the introduction of PEM, such underlying companies are not taxable in Taiwan. However, with introduction of the PEM, such underlying companies might be taxable in Taiwan if all of the three conditions that constitute a PEM are met.

Taiwanese taxpayers and multinational companies doing business in Taiwan should closely monitor progress and content of these two new rules and endeavor to restructure businesses in Taiwan when necessary.

Thailand

Remedy for Board of Investment companies?

by Panya Sittisakonsin and Nopporn Charoenkitraj (Bangkok)

Background

On 16 May 2016, the Supreme Court of Thailand interpreted the *Investment Promotion Act B.E. 2520* (“IPA”) in a manner which was seen by many as breaching the reasonable expectations and reliance interest of many foreign as well as domestic investors. Reasoning that the IPA does not stipulate any specific method in the computation of net profit, the Supreme Court ruled that the Revenue Code’s provisions must prevail with regard the computation method of net profit and loss deriving from Board of Investment (BOI)-promoted activities. The Revenue Department’s position, in effect, prevails. However, certain legal practitioners and scholars were and have remained doubtful whether this interpretation of the IPA would prevail in future decisions.

Subsequent to the decision, BOI-promoted companies must now include its profit and loss from each and every one of its BOI-promoted projects to offset one another in order to be eligible to benefit from Sections 31 Paragraph 4 of the IPA (the “Tax Loss Benefit”) and the 5 percent deduction from increased export income benefit under Section 36(4) of the IPA must be taken into consideration based on the total income of all promoted projects.

However, to normalize the investment landscape, on 16 June 2016, the Minister of Finance exercised his authority under Section 3 Octo Paragraph 2 of the Revenue Code and issued the *Ministerial Notification On the Time Extension for Corporate Income Tax Return Pursuant to the Revenue Code* (the "Notification") to help BOI-promoted investors who unwittingly found themselves to be in default of their tax liabilities as a result of the decision in May.

After the issuance of the Notification, it has been controversial among BOI-promoted companies that the Notification's limited scope was problematic. Some continually sought the justice, equalization and fairness from the Government. As such, on 29 July 2016, in his capacity as the Leader of the National Council for Peace and Order (the "NCPO"), Prime Minister and Commander in Chief Prayut Chan-o-cha has issued an order titled the *Order from the National Council for Peace and Order No. 45/2559* (the "Order"). This Order was issued under the executory authority under Section 44 of the 2014 Constitution of the Kingdom of Thailand (Interim).

The Order

The Prime Minister acknowledges the damages incurred by BOI-promoted companies as a result of the Supreme Court's judgement rendered on 16 May 2016. Section 44 of the 2014 Constitution of the Kingdom of Thailand (Interim) states, "*[f]or the sake of the reforms in any field...or the prevention, abatement or suppression of any act detrimental to... national economy or public administration...the Leader of the National Council for Peace and Order, with the approval of the National Council for Peace and Order, may issue any order or direct any action to be done or not to be done, irrespective of whether the order or action would produce legislative, executive or judicial effect. Those orders or actions, as well as their observance, shall be deemed lawful, constitutional and final. After the exercise of such power, the President of the National Legislative Assembly and the Prime Minister shall be informed thereof without delay.*" (translated and paraphrased)

Through the exercise of this broad and powerful executory authority, the Prime Minister wishes to express his comprehension of the situation with regards to the diverging statutory interpretation between the two governmental institutions, which caused many BOI-investors to incur monetary damages in the forms of increased tax liabilities as well as penalty fees and surcharges. As such, the dominant purpose of the Order is to provide investors, domestic and foreign alike, with confidence and reassurance in their good faith reliance of Thailand's investment incentive law. The Prime Minister understands and appreciates the gravity of the conflicting interpretations between the Revenue Department and the BOI, and ramification that this may have on international investors' perception of the Thai economic climate. Furthermore, the Prime Minister is also cognizant of the shortcomings of the Notification by the Minister of Finance.

For the preservation of investors' good faith reliance on the now inoperable accounting method that had until recently been allowed by the BOI but was later nullified by the Supreme Court's decision, therefore, the Prime Minister has issued the Order with the objective to address the shortcomings and the patently narrow scope of redress provided under the Notification. Thus, the Order extends the deadline for filing both corporate income tax returns for affected companies as well as partnerships to 15 August 2016.

Under the Order¸ Section 2 of the Ministry of Finance's Notification, which grants an extension for affected businesses to file their income tax returns, shall, until 15 August 2016, apply with necessary adaptations to enable affected businesses to refile their income tax returns until the stated date. Furthermore, affected businesses may also apply for the refund of any surcharges or penalties that they may have already paid for as a result of having been rendered to be retrospectively in delinquency due to the accounting method that has been upheld by the Supreme Court.

Nonetheless, the Order is not without ambiguity. Section 2 of the Order leaves many practitioners and investors questioning whether or not all the shortcomings that the Ministry of Finance's Notification has sought to addressed have been remedied as well as what the roles and responsibilities of the BOI

should be in the restitution process of the affected companies. Among other ramifications on the rights and benefits under the IPA in light of the Supreme Court's decision are Section 36 (4)'s right to deduction 5 percent from increased annual export income, Section 34's dividend withholding tax exemption, as well as Section 35 (1)'s corporate income tax reduction have not been restored to their former integrities. Section 2 of the Order states:

"*The extension under paragraph one of Section 2 of the Notification, which is authorized under Section 3 Octo Paragraph 2 of the Revenue Code, shall apply mutatis mutandis with regards to the affected companies with regards to the previously non-compliant computation method(s) employed in the filing of their corporate income tax returns, which, but for the divergent statutory interpretation between the government agencies of Thailand, have not been committed with the intention of avoiding their tax liabilities, as stipulated by Section 3 of the Notification.*" (translated and paraphrased)

From the excerpt of Section 2 of the Order, practitioners as well as investors remain uncertain with regards to what other restitution remedies may be attained by this Order in addition to the refund of the penalty fees and surcharges. The question that remains, thus, is whether or not this Order has done enough to fully restore the rights and benefits under the IPA to their formal integrity.

Nonetheless, many practitioners believe that the wording of Section 2 of the Order, read in combination with the spirit and intention expressed therein, may be interpreted to be sufficiently comprehensive so as to address most of the shortcomings of the Notification. However, it has been widely suggested that the Revenue Department has interpreted the ambiguity of Section 2 of the Order as simply a deadline extension of the Ministry of Finance's Notification, which the Revenue Department contends, also covers the effects inflicted upon the original taxpayer involved in the Supreme Court's decision. This interpretation is seen to be the Revenue Department's stance on the accounting practice contention, notwithstanding the clearly worded intention and purpose of the Prime Minister's Order. Therefore, more intra-governmental statutory interpretation conflict may arise and BOI-promoted investors should take precautions before committing themselves to any accounting method for tax purposes.

As the Prime Minister has expressed his view that it would be incumbent on the BOI to provide support and to promote investments in Thailand through means of consultation and clarification of legal assumptions and understandings with regards to the practical application and implications of the laws relating to the BOI, perhaps, the BOI should take the initiative to address the damages inflicted upon many foreign and domestic investors who had relied on the BOI's accounting method in good faith. Ultimately, however, the implementation of the Order as well as its implications on each of the effected provisions of the IPA would depend on the NCPO's clarification. Lastly, the Order states that the Ministry of Finance and the BOI should also consult each other to clarify any ambiguities in the IPA as soon as possible. Nevertheless, although the IPA falls within the administrative purview of the BOI, as the Revenue Department and the BOI may once again enter into a dispute, investors are advised to consult with the BOI and the NCPO, respectively, for further confirmation prior to adopting a new tax computation method. In the absence of any clear agreement between the BOI and the Revenue Department, affirmation from the NCPO may at least have some evidentiary value in tax litigations.

Turkey

Turkey to introduce a new tax amnesty law

by Erdal Ekinci and Gunes Helvaci (Istanbul)

In an effort to ensure the sustainability of the national economic growth, reduce the burden of public debts incurred by the private sector and encourage taxpayers to resolve tax law disputes without litigation, the government prepared a new comprehensive law on the restructuring of public receivables. On 19 August 2016, "Law on the Restructuring of Certain Receivables" (Law) was published in the Official Gazette and has entered into force.

The Law introduces a new tax amnesty for certain tax receivables and Turkish residents' assets abroad. Furthermore, the Law also includes a voluntary tax base increase, which provides a protection against tax audits for related taxes.

Tax amnesty for tax receivables at the tax inspection or tax assessment stage

Tax inspections and tax assessments that are initialized but have not yet been completed by the promulgation date of the Law will continue to be carried out. Once these tax assessments are completed, 50 percent of the original tax amount, the entire tax loss penalty and the related late payment interests will be written off if the taxpayers pay the first 50 percent of the original tax amount and the amount to be calculated based on the Producer Price Index (PPI) monthly rates until the promulgation of the Law.

Tax amnesty for tax receivables at the litigation stage

The entire tax loss penalty, the related late payment interests and the remaining original tax amount after the following reductions will be written off provided that the taxpayer has paid the following items:

- 50 percent of the original tax amount and the amount to be calculated based on the PPI monthly rates until the promulgation of the Law for tax assessments that have not yet been finalized in the court of first instance or in the reconciliation process, or if the term of litigation has not yet been passed.

- 20 percent of the original tax amount and the amount to be calculated based on the PPI monthly rates until the date the Law is promulgated if the last decision on the tax assessment made before the promulgation of the Law has been made in favor of the taxpayer.

If the last decision has been given against the taxpayer before the promulgation of the Law, the entire original tax amount and the amount to be calculated based on the PPI monthly rates until the promulgation of the Law must be paid, in order for the entire tax loss penalty and the late payment interest to be written off.

Tax amnesty for finalized tax receivables

The tax amnesty addresses tax receivables that have not been paid on time, as well as tax receivables of which payment period has not yet expired as of the date the Law is published in the *Official Gazette*. If the taxpayer pays the entire tax amount and the amount to be calculated based on the PPI monthly rates until the promulgation of the Law, the entire tax loss penalty and delay interests will be written off.

Tax base increase mechanism for income and corporate income taxpayers

The Law states that if income and corporate income taxpayers increase their annual corporate income tax bases for fiscal years 2011 to 2015, at the rates specified in the Law, no tax inspection or tax assessment will be conducted on these taxpayers regarding the taxation period and tax type for which they increased their tax base.

Within this context, no tax inspection or tax assessment will be conducted for income and corporate income taxpayers if they increase their tax base by no less than: (1) 35 percent for 2011; (2) 30 percent for 2012; (3) 25 percent for 2013; (4) 20 percent for 2014; and (5) 15 percent for 2015.

The increased tax base will be subject to a corporate income tax rate of 20 percent. This rate is reduced to 15 percent if the taxpayers: (1) filed their corporate income tax return in due time for the fiscal year for which they want to increase the corporate income tax base; (2) duly paid the taxes due; and (3) do not benefit from the tax amnesty for tax receivables at the litigation stage or finalized tax receivables provided in the Law.

Tax base increase mechanism for VAT taxpayers

No tax inspection or tax assessment will be conducted for value-added tax (VAT) taxpayers for the taxation periods in which they increased their annual VAT tax base. The annual VAT tax base increase for each taxation period is: (1) 3.5 percent for 2011; (2) 3 percent for 2012; (3) 2.5 percent for 2013; (4) 2 percent for 2014; and (5) 1.5 percent for 2015.

Business records correction

Inventory and fixed assets declarations

- Income and corporate income taxpayers can record their inventory, machinery, equipment and fixed assets that are not recorded in the company's books but are physically held in the enterprise without triggering any tax loss penalty.
- To benefit from this provision, taxpayers should declare these assets to their tax office through an inventory list that details the assets and their fair market values by the end of the third month following the promulgation of the Law.
- If those assets are typically subject to 18 percent general VAT rate, 10 percent VAT should be declared and paid over the declared value of the assets. If the assets are subject to a reduced VAT rate, the half rate of the reduced VAT rate should be used when calculating the VAT to be declared and paid.

Recorded assets that aren't physically present in the enterprise.

- Income and corporate income taxpayers will be able to correct their business records without triggering any tax loss penalty and late payment interests for their recorded assets that are not physically present in the enterprise by: (1) issuing an invoice; and (2) fulfilling the related tax liabilities by the end of the third month following the promulgation of the Law.

Recorded cash balance and receivables from shareholders not involved in the enterprise.

- Corporate taxpayers can correct their business records regarding the cash balance and receivables recorded in their balance sheet as of 31 December 2015, but are not involved in the enterprise by declaring them to their registered tax office. These amounts will be taxed at a rate of 3 percent. No additional tax assessment will be made for these declared amounts.

Payment Methods

To benefit from the tax amnesties and the tax base increase mechanism, taxpayers must apply to their tax office by the second month following the date in which the Law is published. In conjunction with their application, they must pay the required amounts stipulated, either at once or in a maximum of 18 equal installments (in which the installments will be paid on a bi-monthly basis), of which the first installment period is the third month following the date in which the Law is published.

As the Law will be published in August, taxpayers will be required to apply for the tax amnesty by October and pay the required amount at once or by the first installment period in November.

If taxpayers pay the required amounts within the scope of the Law at once within due time, they will enjoy the following benefits:

- No interest will be calculated from the date in which the Law is published until the payment date.
- The amount to be calculated based on the PPI monthly rates until the promulgation of the Law will be reduced by 50 percent.

If taxpayers prefer to pay the required amount in installments, they must do so in six, nine, 12 or 18 installments. In this case, the required amount will be multiplied by (1) 1.045 for the six equal installments option; (2) 1.083 for the nine equal installments option; (3) 1.105 for the 12 equal installments option; and (4) 1.15 for the 18 equal installments option.

Tax amnesty for Turkish residents' assets abroad

Legal entities and real persons that are resident in Turkey can bring into Turkey their money, gold, foreign currency, securities and other capital market instruments by or before 31 December 2016.

No tax audit, tax assessment, investigation or prosecution will be conducted due to the arrival of these assets in Turkey. Assets brought from abroad under the amnesty can be recorded in companies' corporate books. There will be no restrictive regulation of the recording process. Adding these assets to companies' share capital, maintaining them in a special account or using them to pay debts will be at the companies' discretion.

These assets will not be taken into account in the calculation of corporate income, and their withdrawal from the company will not be deemed a dividend distribution. Therefore, they will not be included in the income tax or corporate income tax basis calculation.

The Law does not provide any information as to how the declaration process will be carried out by the taxpayers who wish to declare their assets abroad in Turkey. We believe that the Law has left this issue to the secondary legislation. We expect that the Ministry of Finance will publish a new communiqué regarding how the notification will be made.

Conclusion

The affected taxpayers should be aware of the Law and take the necessary steps to benefit from the new tax reliefs.

United Kingdom

Behind the veil: corporate transparency in the UK

by Alex Chadwick and Jill Hallpike (London)

Close scrutiny of corporations is high on the political agenda following recent events (the 2008 financial crisis, public outrage at the tax affairs of multinational companies, LuxLeaks and the 'Panama Papers' controversy). The chart (See *Corporate Transparency | Tax and Other Obligations Table* below) sets out the international and domestic law rules with which companies must now comply requiring disclosure of their affairs.

A multitude of transparency obligations have been adopted or proposed by the OECD, the European Union, and the UK Government. These transparency obligations can, broadly speaking, be grouped into: **tax compliance, anti-tax avoidance**, and **conduct of business obligations**.

In relation to **tax compliance** obligations:

- the UK Government has introduced or is planning to introduce rules which require certain entities:
  - to publish an annual tax strategy; and
  - to certify (via their 'senior accounting officer') to the UK's tax authority (HMRC) that appropriate tax accounting systems are in place.

In relation to **anti-tax avoidance** obligations:

- the UK Government has introduced or is planning to introduce rules which:
  - require entities to inform HMRC of tax avoidance schemes;
  - require entities to notify HMRC if they are likely to be subject to diverted profits tax;
  - require entities to actively consider whether their tax arrangements are 'abusive';
  - require certain entities to provide reports to HMRC (by introducing the OECD's recommendations regarding country-by-country reports); and
  - would impose criminal liability on entities which fail to prevent tax evasion; and
- the European Union is currently considering a proposal which would require certain entities to publish country-by-country reports in the public domain (via websites and public registers).

In relation to **conduct of business** obligations:

- the UK Government has introduced or is planning to introduce rules which:
  - require certain entities to identify and disclose any 'persons with significant control'; and
  - would impose criminal liability on entities which:
    - make or accept bribes;
    - fail to prevent bribery by those acting on their behalf; or
    - do not maintain proper procedures to prevent fraud and money laundering.

Further details of the most important elements of the above transparency obligations (namely, effective dates, responsibility, deadlines for compliance, and penalties) are summarised in the chart.

All these measures will enable tax authorities to obtain additional information regarding the tax and wider business affairs of multinational corporations. In turn, this could give rise to an increase in the number of enquiries and disputes. However, failure to comply with the measures would inevitably have reputational consequences. As such, it is critical that entities understand precisely and fully the scope and their ramifications.

Corporate Transparency | Tax and Other Obligations

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
TAX COMPLIANCE						
Publication of tax strategy	Certain multinational groups that include a UK company are required to publish an annual tax strategy.	Once the Finance (No. 2) Bill 2016 has been passed.	Head of group; the strategy must then be published online by each UK group entity.	The first filing deadline will be by the end of the first financial year that begins after the bill gains Royal Assent (expected October 2016). Thereafter, before the end of the relevant entity's financial year.	• Failure to publish a tax strategy within the prescribed period - up to £7,500. • Non-compliance for first six months - £7,500. • Continued non-compliance - £7,500 per month.	Finance (No. 2) Bill 2016, section 149 & Schedule 19.
Senior Accounting Officer rules	The SAO must certify to HMRC that appropriate tax accounting systems have been in place throughout the financial year.	In effect.	Senior Accounting Officer; the relevant entity.	By the end of the period for filing the company accounts for the financial year.	• SAO - personally liable for £5,000 per breach. • Company - faces a fine of £5,000 for failing to disclose identity of its SAO.	Finance Act 2009, Schedule 46.

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
ANTI-TAX AVOIDANCE						
Disclosure of Tax Avoidance Schemes (DoTAS)	Companies and/or their advisors must inform HMRC about tax avoidance schemes that bear statutory “hallmarks”. (In some circumstances, schemes can benefit from legal privilege).	In effect - subject to updates contained in the pending Finance (No. 2) Bill 2016.	Scheme promoter, often the relevant entity itself.	Within 5 days of the scheme being made available or implemented.	• Failure to notify: up to £5,000 per day. • Failure to comply with regime or to provide information: up to £5,000 per day. • User penalties e.g. failure to report scheme reference number(s) to HMRC: up to £1,000 per scheme.	Tax Avoidance Scheme (Penalty) Regulations 2007 (SI 2007/3104).
Diverted Profits Tax (DPT)	The relevant entity must notify HMRC if the conditions for DPT are likely to be met for an accounting period.	In effect.	The relevant entity.	Within three months of the end of the relevant accounting period.	• Up to 30% of potential lost revenue, rising to 70% for deliberate failure to notify and 100% for deliberate and concealed failure.	Finance Act 2008 Schedule 41

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
General Anti Abuse Rule (GAAR)	Companies must actively assess whether their tax arrangements are "abusive" and act to counteract any resulting tax advantage.	In effect, pending new penalties introduced by the Finance (No. 2) Bill 2016.	The relevant entity.	Assessment must be made at the time a tax return is filed.	• Penalty fixed at 60% of the value of the counteracted tax advantage (once Finance (No. 2) Bill 2016 has been passed).	Finance Act 2013, Part 5; Finance (No. 2) Bill 2016, clause 146.
Tax authority (OECD) country-by-country reporting	The UK rules require UK headed multinational enterprises, or UK sub groups of multinational enterprises, to make an annual country-by-country report to HM Revenue and Customs, showing for each tax jurisdiction in which they do business: (1) the amount of their revenue, profit before income tax, and income tax paid and accrued; and (2) their total employment, capital, retained earnings, and tangible assets. Groups should be aware of how the rules have been implemented in other countries and possible differences in timing/information requirements.	In effect.	The relevant entity.	Reports will be required to be filed for accounting periods beginning on or after 1 January 2016. Reporting entities will have 12 months from the end of the relevant accounting period to file a report with HMRC.	• The penalties start at £300 for failure to comply (and increase for persistent failure) and £3,000 for the provision of inaccurate information.	Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016.

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
Public (European Commission) country-by-country reporting	The proposed measure would require: (1) EU-headquartered multinationals with a consolidated turnover of at least EUR 750 million; and (2) certain EU subsidiaries and branches of non-EU headquartered multinationals with a consolidated turnover of at least EUR 750 million, to publish financial, tax, and contextual information on worldwide operations, broken down by EU member state and tax haven jurisdictions, and aggregated for non-EU jurisdictions.	Should the proposal be adopted by the European Parliament and Council, the Directive must then be transposed into national legislation within **one year after its entry into force**.	In respect of parent and subsidiary undertakings - members of the administrative, management and supervisory bodies; In respect of branches - the person(s) designated to carry out the disclosure formalities for the branch, to the best of their knowledge and ability. Member states must also ensure that, if an undertaking's financial statements are audited, the audit report includes a statement on whether the country-by-country report is provided and made accessible.	The country-by-country report must be published on the relevant entity's website and remain available for five consecutive years. The report must also be filed in a public register. Further detail regarding timings and deadlines is to be determined at Member State level.	• These are to be determined at Member State level.	Pending - The initiative is currently in the form of a proposed Directive (put forward by the European Commission).
Corporate offence of failing to prevent tax evasion	An entity will face **criminal** liability where: (1) a taxpayer commits a tax evasion offence; and (2) a related facilitation offence is committed by a person that is associated with said entity, unless said entity had 'reasonable procedures' in	Anticipated Autumn 2017.	Liability is imposed on the entity itself, and so not its management, shareholders and directors (in the case of a company), or its partners (in the case of a partnership).	N/A.	• No detail yet	Pending - The initiative is currently in draft form while HM Revenue & Customs undertake a consultation exercise.

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
	place to prevent such facilitation.					
OTHER OBLIGATIONS						
Register of Persons with Significant Control (PSC)	UK companies (exc. listed PLCs) must take reasonable steps to find out (and maintain a register of) any "persons with significant control" over it. This information must also be supplied on its annual return.	In effect.	The relevant entity; its officers.	The register must be maintained now; the same information must be supplied by the date of the relevant entity's annual return.	• Breach attracts criminal liability for the company and its officers, possibly resulting in fines and/or two years' imprisonment.	Small Business, Enterprise and Employment Act 2015, section 81.
Bribery Act 2010	In addition to it being an offence to make or accept a bribe, companies face strict liability for failing to prevent bribery by those acting on their behalf.	In effect.	The relevant entity.	N/A.	• Companies can face unlimited fines. • (A company has a defence if it can prove it had "adequate procedures" in place).	Bribery Act 2010, section 7.

Obligation	Description	Effective date	Responsibility	(Filing) Deadline	Penalties	Statutory reference
Corporate offences of failing to prevent fraud and money laundering	UK companies will be expected to demonstrate that they have proper procedures in place to prevent the conduct of fraud or money laundering. In parallel to this, foreign companies that own UK properties will have to publicly disclose ultimate ownership details before being able to purchase property or to bid for central government contracts.	Proposed May 2016.	The relevant entity.	N/A.	• No detail yet	Pending - The initiative was announced by the UK Prime Minister at the Anti-Corruption Summit on 12 May 2016.

May 2016

Taxation of UK resident non-domiciliaries - update

by Ashley Crossley, Phyllis Townsend, Katherine Davies, Paula Ruffell, Vadim Romanoff, David Whittaker and Christopher Cook (London)

In the Summer Budget of 2015, the UK Government announced significant changes to the taxation of UK resident individuals who are electing to be taxed as non-UK domiciled ("RNDs"), i.e. on a remittance basis.

The Government's proposals included the announcement that, from April 2017, those who have been resident in the UK for at least 15 out of the previous 20 UK tax years (the "15/20 test") would be treated as "deemed domiciled" for *all* UK tax purposes.

On 19 August 2016, the Government released further details on the incoming changes, which included a further consultation document and draft legislation.

The consultation has confirmed the Government's intention that the changes should be implemented from April 2017. The following key points have been raised:

<u>Taxation of non-UK resident trusts settled by long term RNDs</u>

Previously, the Government had suggested that RNDs caught by the new rules should be taxed by reference to the value of benefits received by the deemed domiciled individual, without reference to the income and gains arising in the trust.

In an apparent change from their previous position, the Government has now suggested in the latest consultation and draft legislation that the current tax provisions that apply to UK resident and domiciled individuals will apply equally to those who are deemed-UK domiciled under the new rules. This could potentially mean that, where an individual who had previously settled a non-UK resident trust becomes deemed domiciled in the UK under the new rules, that individual will be taxed on both the income and capital gains arising in the trust on an arising basis.

However, in order to deliver a certain degree of protection for individuals who settled trusts prior to being deemed domiciled in the UK, the Government has proposed that the legislation does not extend to the deemed domiciled settlor of a non-UK resident trust where the trust was set up before they became deemed domiciled and no additions of property have been made since that date. However, if the settlor, their spouse, or their minor children and/or stepchildren receive any actual benefits from the trust then the protection will not apply.

The Government's consultation proposes that offshore trusts set up as "excluded property" settlements under the UK inheritance tax ("IHT") legislation will remain as such, and will therefore continue to be outside the scope of the settlor's estate for IHT purposes, with the notable exclusion of UK residential property (see below).

<u>Rebasing foreign assets for UK capital gains tax ("CGT") purposes</u>

In preparation for the changes coming into effect, the Government announced in the 2016 Budget that those individuals who will become deemed domiciled in April 2017 (because they meet the 15/20 test) will be able to rebase directly held foreign assets to their market value on 5 April 2017.

The Government proposes that those individuals will therefore be able, if they wish, to rebase overseas assets to the market value of the asset at 5 April 2017, with the result that any gain which accrued before April 2017 will not be charged to CGT in the UK.

This is due to apply to unrealised gains only and does not provide an 'amnesty' for reinvested foreign income and gains.

Those individuals who become deemed domiciled in years after April 2017, and those who become deemed domiciled because they were born in the UK with a UK domicile of origin will not be able to rebase their foreign assets. In addition, clients (including trustees) with structures should undertake a review of their assets as there may be a limited window for planning where automatic rebasing is not available.

Many clients should consider the possibility of rebasing in conjunction with 'reorganising' their foreign income and gains (see below).

Offshore funds of foreign income and gains

The proposed reforms mean that those RNDs who become deemed domiciled in April 2017, and had previously elected to be taxed on the remittance basis, will have to pay tax in the UK on their offshore income and gains on an arising basis for the first time.

For those individuals who had not previously segregated income from capital, the changes could potentially mean that such persons with a "mixed fund" of un-segregated income and capital will find it difficult to bring any money from the fund into the UK without paying tax at their top rate.

To counter this problem, the Government has announced a temporary window in which any RNDs (i.e. not just those who become deemed domiciled in April 2017) except those born in the UK with a UK domicile of origin or those who had not previously elected to be taxed on the remittance basis, will be able to rearrange their mixed funds to enable them to separate those funds into their constituent parts (i.e. income from capital and capital gains) and choose from which account they remit funds.

This special treatment is due to apply to mixed funds which consist of amounts deposited in bank and similar accounts where an individual is able to identify the source of those funds. Additional planning should be available in relation to non-cash assets, e.g. a valuable painting, which would need to be sold before this treatment can be applied to the sale proceeds.

This window will last for one tax year from April 2017 and it will provide certainty on how amounts remitted to the UK will be taxed provided clients review their assets and establish the different elements of offshore accounts at 6 April 2017 to benefit from this opportunity

Individuals returning to the UK

The Government confirmed that RNDs who leave the UK prior to April 2017 will be within the new rules when they are introduced, even if they returned before the announcements were made. This means that those who left the UK and broke deemed domicile status for IHT purposes after four tax years of non-UK residence will be deemed domiciled in the UK from 6 April 2017 if they meet the 15/20 test, and so are not protected from the effect of these reforms.

In addition to the changes regarding long term RNDs, the 2015 Summer Budget had announced changes for those born in the UK who had previously held a UK domicile at birth, who subsequently return to the UK after a period abroad and, upon their return to the UK, assert a foreign domicile.

The consultation has confirmed that, subject to a grace period for those who return temporarily and were not UK resident in either of the prior two tax years, such individuals will now be considered to be UK domiciled for all tax purposes and an individual who was born in the UK will be unable to assert a foreign domicile for any period whilst they are UK resident. Whilst the Government intends that an individual's foreign assets are outside the scope of IHT during the grace period (e.g. to allow individuals to rewrite wills), the Government does not intend that the grace period will allow returning UK domiciliaries to be able to use the remittance basis of taxation.

It should also be noted that trusts established by returning UK domiciliaries will lose "excluded property" status, meaning that assets held within the trust will be subject to IHT.

IHT on UK residential property

Another significant measure put forward previously by the Government was a proposal to bring all UK residential property held directly or indirectly by non-UK domiciliaries (or trusts established by them) into the scope of IHT.

Under current rules, IHT is only charged on UK property held directly by non-UK domiciliaries (who are also not deemed domiciled in the UK), and a common planning strategy had therefore been for non-UK domiciliaries or their structures to own UK property through an offshore company or similar vehicle and in doing so remove that property from the scope of IHT.

To implement the extended IHT charge, the Government proposes to remove UK residential properties owned indirectly through offshore structures from the current definitions of "excluded property". The effect will be that such UK residential properties will no longer be excluded from the charge to IHT. This will apply whether the overseas structure is owned by an individual or a trust.

Given that holding a UK residential property in a structure or "corporate envelope" may no longer be recommended from a UK tax perspective, there had been speculation as to whether there would be an incentive or concession to allow those with property holding structures to "de-envelope" without the associated costs (such as capital gains tax on the disposal, stamp duty land tax etc.). The Government has advised in the consultation that, notwithstanding there being a case for encouraging de-enveloping, it does not think it would be appropriate to provide any incentive or concession to encourage individuals to exit from their enveloped structures at this time.

Business Investment Relief ("BIR")

In 2012, the Government introduced a special relief known as BIR, which was designed to encourage RNDs who are taxed on the remittance basis to invest their foreign income and gains into UK businesses. In the further consultation, the Government has announced that it plans to extend the availability of BIR and possibly widen the categories of "qualifying investments" that currently qualify. At this time, there is little detail known about how the Government intents to extend BIR and the consultation is being used to seek stakeholder views.

Conclusion

Given the potentially far reaching and significant tax consequences that could arise out of the Government's proposals we would strongly advise any individuals who may be caught by the changes to seek a review of their current tax affairs and assets in sufficient time before April 2017.

United States

The CFTC proposes significant relief for non-US market participants

by Matt Kluchenek and Michael Sefton (Chicago)

The US Commodity Futures Trading Commission ("CFTC"), which regulates commodity interest transactions such as swaps and futures contracts, has requested comments from industry market participants on its proposed amendments to CFTC Rule 3.10. CFTC Rule 3.10 sets forth the exemptions that may apply to non-US market participants, and the rule impacts brokers, advisers and fund operators.

The CFTC's stated goal, subject to receiving comments, is to expand the exemptions from registration for non-US firms engaged in commodity interest transactions in the US on behalf of customers located outside of the US The proposal also seeks to simplify the exemptions' requirements.

For non-US firms, this could be a major development if ultimately promulgated by the CFTC, in that the amendments would significantly broaden the exemptions under CFTC Rule 3.10.

In this Client Alert, we examine the proposed amendments to CFTC Rule 3.10 and the exemptions. In light of the proposal, a non-US firm should determine whether it can meet the proposed requirements, and how reliance on the exemptions will allow it to participate in US markets on behalf of its customers. In addition, a non-US firm should consider whether any changes, or other suggestions, should be provided to the CFTC during the 30-day comment period. Comments in support of the proposal are also encouraged.

The proposed exemptions would apply to non-US persons acting solely as a "foreign broker," or otherwise acting as an intermediary only with respect to persons located outside of the US, and exempt such non-US persons from registration as futures commission merchants ("FCMs"), introducing broker ("IBs"), commodity trading advisors ("CTAs") or commodity pool operators ("CPOs").

Currently, CFTC Rule 3.10 (c)(3)(i) exempts non-US persons from registration as an IB, CTA or CPO for certain non-US activities involving commodity interest transactions (including commodity futures and swaps) executed bilaterally, or made on or subject to the rules of an exchange or a swap execution facility ("SEF") in the US if the following conditions are met: (1) the person is located outside of the US; (2) the person acts only on behalf of persons located outside of the US; and (3) the commodity interest transaction is submitted for clearing through a registered FCM. CFTC Rule 3.10 (c)(2)(i) provides similar exemptive relief for any non-US person acting as an FCM.

The proposal would remove the clearing requirement set forth in item (3) above, and simply require that the firm be located outside of the US and act only on behalf of customers or clients located outside of the US

In discussing the proposal, the CFTC states that it believes that "the focus on the exemption should be the activity of the [Non-US Person], not its customer." Additionally, the CFTC notes that the proposal is consistent with its policy to focus domestically on customer protection activities, and that where a non-US person's customers are located outside the US, the jurisdiction where the customer is located has the "preeminent interest" in protecting such customers.

While the CFTC's proposal is a welcomed step, there are questions regarding the scope of the relief. For example, who is considered to be a "person located outside of the US"? Would this include US citizens temporarily residing outside of the US? Questions such as these will need to be addressed during the comment period.

Impact on business valuations of lapsed rights and restrictions on liquidation of an interest: Is this the end of valuation discounting as we know it? - Section 2704 proposed regulations released

by Glenn Fox (New York), Ceci Hassan, Daniel Hudson (Miami), Rodney Read (Houston), Kevin Keen (Zurich), Elliott Murray (Geneva), David Berek (Chicago) and Marnin Michaels (Zurich)

General background

On 2 August 2016, the Treasury Department released the much anticipated proposed Treasury Regulations under Code Section 2704, providing clarification and imposing further limitations on the use of valuation discounts for transfers of interests in family controlled entities for transfer tax purposes. The Proposed Regulations will thus create higher valuations for transfer tax purposes, which will result in higher transfer tax liabilities but also larger basis step-ups. The Proposed Regulations, if enacted in their current form, among other things, would essentially eliminate discounts for minority control and lack of marketability in transfer tax valuations of interests in closely held entities (e.g., family limited partnerships, closely held corporations, and other family controlled entities).

A hearing with respect to the Proposed Regulations is scheduled for 1 December 2016, and comments are welcome by 2 November 2016. It is important to note that these regulations are proposed only. The regulations will become effective with respect to "lapsing voting and liquidation rights" and transfers subject to "applicable restrictions" that occur on or after the date of final publication. With respect to transfers subject to newly defined "disregarded restrictions," the regulations will become effective 30 days following the date of final publication.

Section 2704 is part of the Special Valuation Rules meant to address the planning tool of the "estate freeze." An estate freeze is a technique that attempts to limit or reduce the value of an interest in a business or other property for estate tax purposes. In many cases, this is accomplished by having the older generation transfer the appreciating interest in a business to the younger generation while retaining a non-appreciating interest.

Section 2704 was enacted in 1990 to provide special valuation rules to apply to intra-family transfers of interests in corporations and partnerships subject to lapsing voting or liquidation rights and to restrictions on liquidation. According to the legislative history, one of the purposes of its enactment was to overrule the decision in *Estate of Harrison v. Commissioner*, T.C. Memo 1987-8.

In *Harrison*, a Texas decedent and his two sons held general partnership interests in a partnership while the decedent also held a limited partnership interest. Any general partner had the right to liquidate the partnership during his life and cause each general partner to obtain the full value of his partnership interests. When determining the estate tax value of the decedent's limited partnership interest, the Tax Court "pinpoint[ed] [its] valuation at the instant of death" and concluded that a discount should be given on the value of the limited partnership interest due to the lack of a right to liquidate (that right having lapsed at death). The result was that the value of the limited partnership interest was found to be less than its value in the hands of the decedent immediately before his death and less than the value in the hands of his family members immediately after his death.

In order to hinder the use of lapsing rights as was found in Harrison, Section 2704 was enacted. Section 2704(a) in general treats lapses of voting or liquidation rights in a corporation or partnership as a transfer subject to US federal transfer taxes where the individual holding such right before the lapse, and the members of such individual's family after the lapse, control the entity. The amount subject to transfer tax is the decrease in value of all the interests held by the holder of the right as a result of the lapse. If the right lapses at death, it increases the holder's gross estate. If it lapses while the holder is alive, it creates a taxable gift.

To discourage the use of artificial restrictions, such as the inability to force the liquidation of a partnership to decrease the estate or gift tax on transfers of closely held business interests, Section 2704(b) requires that such restrictions be ignored in certain cases. These are so-called "applicable restrictions." If a taxpayer transfers stock or a partnership interest to a family member, and such corporation or partnership is controlled by the family immediately before the transfer, any restriction that limits the ability of the corporation or partnership to liquidate (in whole or in part) will be ignored for estate and gift tax purposes if the restriction lapses after the transfer or if the transferor and the transferor's family have the power to remove it.

Explanation of changes

Entities covered and classifications. Current rules indicate that Section 2704 applies to corporations and partnerships. The Proposed Regulations state that Section 2704 continues to apply to corporations and partnerships, but clarify that included within the meaning of partnership is any other business entity regardless of how the entity is classified under the check–the-box rules (e.g., LLCs), and regardless of whether it is US or foreign. Also, in analyzing control of an entity and state law restrictions, the Proposed Regulations look to local law (where the entity was created) to determine such rights, regardless of how such entity is classified for federal tax purposes (e.g., as an entity disregarded from its owner).

Lapse of voting or liquidation rights and death bed transfers (three-year rule). Under current regulations, a lapse of a liquidation right occurs at the time such right is restricted or eliminated, and lapses that occur as a result of a transfer of an interest in the family controlled entity are excluded (the exception). For example, a father transfers his 100 percent interest in a family company to each of his four children, 25 percent to each. Each of these transfers could theoretically be seen as a lapse because no one child could exercise voting control as the father did before the transfer. Provided that none of the liquidation rights were changed as a part of the transfer, the exception applies and this is not a lapse under current law.

The Proposed Regulations alter this rule by requiring that the transferor (in the example above, the father) survive for three years. Thus, this exception will only apply to such transfers which occur more than three years before the death of the transferor. In other words, transfers within three years of death will be treated as transfers under Section 2704 on the transferor's date of death and the minority valuation discount will be includable in the transferor's gross estate, thereby essentially eliminating the minority discount in this case.

Of course, the three-year "look-back" rule of the Proposed Regulations does not eliminate the ability to apply a minority interest discount at the time of the transfer, so long as the transferor survives the three-year period and the voting/liquidation rights are not changed as part of the transfer. However, the inclusion of the minority valuation discount in the gross estate should the transferor die within the three-year period will create a "phantom asset" for the estate and a question about who should bear the estate taxes. For those with Wills that require all estate taxes to be paid from the residuary estate (which may pass to beneficiaries other than those who received the interests during the transferor's lifetime), consideration should be given to either including a formula estate tax clause in the Will or providing that the estate bears estate taxes on assets passing under the Will, and that the donees of all other assets passing outside of the Will and by lifetime gifts bear the estate taxes with respect to those assets.

Elimination of discounts on transfers to assignees. In general, a partnership interest (or membership interest in an LLC) may be assigned without the consent of the entity. However, such assignee will not be admitted as a partner or member of the entity absent the entity's consent. Thus, an assignee generally has no control or management rights, or the level of control is at least uncertain. For example, a father passes away owning a 30 percent partnership interest. His son inherits the interest as an assignee. For these reasons, under current rules, assignee interests may be discounted for lack of control and the uncertainty or lack of rights under state law. The Proposed Regulations would treat a transfer to an

assignee as a lapse of the rights associated with such interest (regardless of whether or not the transferor retained such rights) and essentially eliminate the lack of control discount.

Ability to liquidate. Current rules provide that Section 2704 does not apply to the lapse of a liquidation right where the interest can be liquidated immediately after the lapse. Local law, as modified by the governing documents of the entity, determines whether an interest can be immediately liquidated after the lapse. The Proposed Regulations clarify that (1) the manner in which an entity may be liquidated is irrelevant (i.e., whether by vote, local law, or other action permitted under the governing documents), and (2) an interest held by a non-family member may be disregarded under the rules of Treas. Reg. § 25.2704-3(b)(4) of the Proposed Regulations (described below).

Disregard of "applicable restrictions" - discounts related to restrictions on liquidation. The Proposed Regulations seek to curb the reduction of the transfer tax value of ownership interests involved in intra-family transfers where the interest holder's ability to liquidate the entity (whether completely or partially) is restricted or limited.

These "applicable restrictions" include any limitation to liquidate the entity (whether arising from governing documents, agreements, or local law) where the limitation will lapse or could be removed by any one or more of the transferor, the transferor's estate, and the transferor's family members following the transfer. The lapse or removal can occur at any time following the transfer, and the specific manner in which the lapse occurs is irrelevant. Ownership interests held through corporations, partnerships, estates, trusts, or other entities are aggregated with the interests held directly by the transferor, the transferor's estate, and the transferor's family members for purposes of determining their ability to remove the restriction.

A limitation would only be disregarded if both of the following conditions are met:

- the interest is transferred to or for the benefit of a member of the transferor's family; and
- the transferor, members of the transferor's family, or both control the entity immediately before the interest is transferred.

If the limitation is disregarded, then the transferor would use normal valuation principles (excluding any discounts that might have been applicable due to the limitation) to determine the fair market value of the transferred interest.

An example of the application of the regulations that disregard applicable restrictions is the following. Assume a mother owns 76 percent of the interests of a partnership and two of her three children each own 12 percent of the interests in the partnership. Further, assume that the partnership agreement requires the consent of all partners to liquidate. The mother dies and bequeaths her 76 percent interest to her third child. The requirement that all of the partners consent to liquidation is an applicable restriction, since it can be removed by the transferor's family (the three children) following the transfer. Since the transferor and members of her family controlled the entity before the transfer, the 76 percent interest passing to the third child will be valued without regard to the applicable restriction (i.e., it will be value as if the 76 percent interest was sufficient to liquidate the partnership). This essentially prevents a discount for lack of marketability.

The Proposed Regulations would continue to allow transferors to take into account two types of restrictions when determining the fair market value of an ownership interest transferred intra-family. The two exceptions from the definition of applicable restrictions are (1) a restriction imposed by federal or state law, and (2) a "commercially-reasonable" exception. In addition, restrictions where all owners hold a "put right" (discussed further below) do not constitute applicable restrictions.

The current regulations provide an exception for restrictions on liquidation that are imposed by federal or state law, including where a restriction imposed by the governing documents is "no more restrictive" than the default state law. Since the current regulations were promulgated, many state legislatures have

enacted statutory restrictions on the ability of limited partners to withdraw or liquidate their interests in a limited partnership. Often, these statutory restrictions provide the ability to circumvent the restriction through other statutory provisions or via the entity's governing documents. The Treasury Department believes that these statutes allow taxpayers to treat nearly all restrictions found in governing documents as "no more restrictive" than state law, which, in turn, results in valuation discounts when the interests are transferred within a family, since the restrictions would not be considered "applicable restrictions."

The Proposed Regulations limit the exception to only those federal or state law restrictions that do not provide for an option to remove, supersede, override, or opt-out. For purposes of this exception, federal or state law includes only the laws of the Untied States, the District of Columbia, and any US state but does not include the laws of any other jurisdiction. There are few, if any, state laws that do not provide for an option to remove, supersede, override, or opt out, so the effect of the Proposed Regulations is to essentially eliminate the "imposed by federal or state law" exception. If the provisions do not meet the exception, the restrictive provision will be deemed an applicable restriction, and therefore will be "disregarded" for valuation purposes.

The second exception to the definition of applicable restrictions is a "commercially reasonable" restriction imposed by an "unrelated person" who injects capital for the entity's trade or business. This exception is unchanged from the current regulations, which require that a capital infusion (equity or debt) must be from a person who is not related to the transferor, transferee, or any of their family members. Related persons include, but are not limited to, an individual's family members, trustees (other than banks) of trusts established by the individual, and corporations controlled by the individual. Neither the current regulations nor the Proposed Regulations define "commercially reasonable."

New disregarded restrictions. Having concluded there are additional restrictions that adversely affect the transfer tax value of an interest but do not reduce the value of the interest to the family-member transferee, the IRS has promulgated in the Proposed Regulations a new category of "disregarded restrictions", which will be ignored for valuation purposes similar to the aforementioned "applicable restrictions." The implementation of these "disregarded restrictions" is intended to avoid, among other things, the outcome of *Kerr v. Commissioner*, 292 F.3d 490 (5th Cir. 2002). In *Kerr*, the Fifth Circuit Court of Appeals held that since an unrelated minority partner, the University of Texas, in the family limited partnership that was the subject of the case, had to consent to remove the restriction on the right to liquidate an interest in the partnership, the restriction was not an applicable restriction (as family members could not remove the restriction).

Under the Proposed Regulations, if an interest in an entity (domestic or foreign) is transferred to (or for the benefit of) a member of the transferor's family and the transferor and/or members of the transferor's family control the entity immediately before the transfer, then any "disregarded restriction" on the right to liquidate the interest in the entity that lapses or that can be removed or overridden by the transferor, the transferor's estate and/or any member of the transferor's family (without regard to certain interests held by nonfamily members) will be disregarded.

Specifically, a "disregarded restriction" under the Proposed Regulations includes any provision that: (i) limits the ability of the holder of the interest to compel liquidation or redemption of an interest; (ii) limits the liquidation proceeds of such interest to an amount that is less than "minimum value"; (iii) defers the payment of the liquidation proceeds for more than six months after the date the holder gives notice of intent to have the holder's interest liquidated or redeemed; or (iv) permits the payment of the liquidation proceeds in any manner other than in cash or property, subject to the limitations set forth in the following paragraph. A disregarded restriction includes any restriction imposed under the terms of the governing documents, any other document, assignment, agreement or arrangement, and with the exception of specified US federal or state law restrictions, includes any restriction imposed under local law regardless of whether the restriction may be superseded by the governing documents or otherwise.

For the above purposes, "minimum value" means the interest's share of the net value of the entity on the date of liquidation or redemption, which value consists of the fair market value of the property held

by the entity reduced only by outstanding obligations of the entity that would be allowable (if paid) as deductions for US federal estate tax purposes if those obligations instead were claims against an estate. In determining whether a provision permits the liquidation or redemption payment in a manner other than in cash or property, the Proposed Regulations provide that a note or other obligation issued directly or indirectly by the entity, by any interest holder in the entity, or by any person related to either the entity or any interest holder, is not considered property. The Proposed Regulations do allow for a limited exception in the case of certain entities engaged in an active trade or business, whereby a note or other obligation may be considered property if the liquidation proceeds are not attributable to passive assets of the entity, and the note itself is adequately secured, paid on a periodic, non-deferred basis at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds.

The exceptions that apply to “applicable restrictions” under the Proposed Regulations, which include those in the current regulations plus an additional “put right” exception, also apply to this new category of “disregarded restrictions.” The “put right” exception applies if each interest holder has a “put” right to receive on liquidation of their interest, cash and/or other property at least equal to the minimum value paid, within six months after the holder gives notice of intent to liquidate, provided that any such “other property” does not include a note or other obligation issued directly or indirectly by the entity, by any interest holder in the entity, or by any person related to either the entity or any interest holder. An active trade or business exception similar to the one described above applies to this definition of “other property” within the Proposed Regulations.

The following is an example of the new disregarded restrictions at work. A father and his two children are partners in a limited partnership where the father owns a 98 percent limited partner interest and each child owns a 1 percent general partner interest. Under the partnership agreement, the partners cannot withdraw from the partnership, and the partnership cannot be liquidated unless all of the partners agree (all must also agree to amend the partnership agreement). Local law would permit withdrawal. The father transfers a 33 percent interest to each of his two children. Since the restriction here limits the ability of the holder of the interest to compel liquidation, members of the transferor’s family may remove or override the restriction. In addition to the family’s ability to remove or override the restriction, the entity was controlled by the family before the transfer, and, therefore, it is a disregarded restriction. Accordingly, the 33 percent interest is valued for gift tax purposes under general valuation rules as if the restriction on liquidation did not exist.

To combat the use of a non-family member “straw-man” to circumvent the application of Section 2704(b), as was done in *Kerr* discussed above, the Proposed Regulations disregard certain interests held by non-family members when determining whether the transferor, the transferor’s estate, and/or the transferor’s family members may remove or override a potential disregarded restriction. Specifically, the Proposed Regulations disregard any interest held by a non-family member that: (i) has been held less than three years before the date of transfer; (ii) constitutes less than 10 percent of the value of all the equity interests; (iii) when combined with the interests of other non-family members, constitutes less than 20 percent of the value of all the equity interests; *and* (iv) where the non-family holder of such interest lacks a put right in the interest as described above. Therefore, in order for a case like *Kerr* to succeed under the Proposed Regulations, the charity (or other non-family partner) must have a significant interest in the entity that can be liquidated in short order.

The overall impact of the Proposed Regulations, including the disregarded restrictions among the restrictions that cannot be taken into account for gift and estate tax valuation purposes, is that the ability to consider a lack of marketability discount when giving or bequeathing an interest in a closely-held family entity is significantly reduced, if not fully eliminated. The reason for this is that the inability to liquidate one’s interest in the entity is one of the essential components of the lack of marketability discount. There may still be some ability to argue that a lack of marketability discount is appropriate even though the inability to liquidate will be disregarded, since the hypothetical willing buyer will still pay more for publicly traded securities than for an interest in a private company, but this discount is greatly diminished.

Conclusion

The Proposed Regulations will significantly hinder the ability to use restrictions on liquidation or voting rights to reduce the transfer tax value of intra-family transfers of ownership interests in entities. Put another way, the traditional valuation discounts for lack of marketability, lack of control, and minority interests, are significantly reduced (if not eliminated in some cases) by the propose regulations. If the Proposed Regulations are enacted and apply to a transferred interest, then the interest will be valued under the generally applicable valuation rules. Accordingly, families may need to consider the appropriateness of past appraisals and valuations of closely-held entities prior to any future transfers of the same assets (e.g., further interests in a partnership). Such appraisals should be revised to take into account the increased valuations under the Proposed Regulations. Failure to do so could result in larger gift and estate taxes than may have been anticipated. Once a family obtains new appraisals under the Proposed Regulations, they can plan for the greater transfer taxes that will be due. In addition, families may want to consider accelerating gifts of closely-held family business interests before the regulations become final (keeping in mind that the new three-year rule discussed above may still result in lapsed rights being included in the transferor's estate).

Reflections[19]

Brexit and wealth management structures

by Marnin Michaels and Peter Mitchell (Zurich)

We will not try to speculate about the ultimate consequences of Brexit, because no one knows what will happen. The reality is that Europe is so integrated today that there will never be a UK exit along the lines of what has been espoused by the UKIP Party; nor will the exit, absent a new referendum to block a UK exit, result in the status quo. What concerns us is some of the language used around Brexit. For example, Mr. Nigel Farage recently and publicly made an attempt to defend the use of the phrase "chinky" to refer to people of Asian descent. Another major figure in UKIP explained that she did not like "negroes". One used to argue that these people were on the fringes, but in the end, their advocacy led to Brexit. Couple with this the repeated acts of terrorism seen in Europe (Paris, Brussels, Copenhagen, and Nice), and our concern is the bigotry and racism inherent in the comments. The terrorist attacks in Turkey are also in this vein. Unfortunately, these events are not limited to Europe. The terror attack on a gay bar in Orlando, the desire to kill Caucasians in Dallas, and the blatant anti-Muslim and anti-Hispanic statements of Donald Trump are as bad or worse as some of the comments and actions coming out of Europe. The extreme rhetoric and behavior reminds us of what we have read about the world in 1933. we have been mulling over their impact on the wealth management industry and its clients for several months, and we offer the following reflections.

1. The difference between a refugee and a migrant is money

We recently sat down with a highly respected CEO of a bank. He said how a very important client of his bank, a very well-to-do Yemenite, had moved his base of operations to Dubai to avoid conflict in his home country. The CEO then said, the only difference between a refugee and someone moving a base of operations is the amount of money in a bank account. In the end, both left their country for fear of persecution or for risk to life, but the amount of money determines how they live their lives. His example illustrates how planning can help individuals address changes caused by racism or hate by locating assets in more than one jurisdiction. Yes, we live in a world of AIEA and FATCA which causes information to be known everywhere. And, yes we live in a world where more banks are concerned with cross-border regulatory issues. However, none of this should discourage people from keeping accounts outside of their home country. There is not a place that on its own is safe enough to hold all of a client's assets.

It may be that banks are concerned about cross-border regulatory issues; however, vehicles like trusts, insurance and foundations (which have sometimes been used inappropriately in the past) may be very important to mobility in a new world. In many cases, the use of wealth management structures may allow financial institutions to take on clients they cannot work with directly.

2. What is your exit strategy?

Several months ago, Marnin was at a dinner party with prominent Jews and was asked a question: "So what's your exit strategy?" he said, "Excuse me?" The response was, "Aren't you concerned about all the recent anti-Semitic attacks in Europe? Don't you have a plan of where you go or what you do if things get too bad?" While he felt this to be a bit on the extreme side, it made him think: should we all have an alternative residency or nationality just in case something goes wrong?

In the weeks since Brexit, we have received many inquiries from people living in the UK without a UK passport who are looking for UK nationality. More interestingly, the number of UK nationals living throughout Europe who have been looking to obtain another passport is really astronomical. It comes up almost daily.

[19] **Views expressed in this section are the personal views of the authors.**

Thus, what became clear for us, in view of Brexit, is that our clients all need to consider alternative nationalities and residences outside of where they live. While this may be a bit draconian in thinking, the discrimination now seen shows that some of our clients will need to have an alternative residence to respond to extremism, instead of react to it.

3. How do we serve our clients

We would argue that the use of wealth management centers to avoid taxation is a historic blip in the history of banking. People have worked with banks in Switzerland for reasons of safety and security long before tax became an issue. Recent examples of extreme language encourage the use of wealth management centers now, more than ever.

4. Tax rates

The instability caused by Brexit will weaken much of Europe in the medium to longer term. That, coupled with the fact that a significant portion of Europe is heading towards retirement age and the fact that a generation became of age during the 2008 recession, means that there will be a huge need for revenue over the next few years. This revenue can only come from one source: higher taxes. Since raising income taxes will be politically difficult, the likely result is that the revenue will come from wealth taxes and inheritance taxes. As such, it is best to plan in view of these likely taxes. Structures, like irrevocable and discretionary structures, are more likely to mitigate these future taxes. The same is true with properly structured life insurance. If this thought process reminds you of times in the first 20 years after World War II, it should - it is the same phenomenon.

Conclusions

Europeans face an intolerance with frightening echoes of the 1930s. It has the power to release forces not seen in over seventy years. For wealth owners, these issues will be particularly trying. Many have already had to confront changing nationalities, moving assets to different jurisdictions, and imminent tax increases. Planning this time can help mitigate some of the impacts of the recurrent themes we saw over seventy years ago. Planning can help deal with these issues.

Artificial intelligence and the Wealth Management space

by Marnin Michaels and Kevin Keen (Zurich)

Several months ago, we read a Facebook post about how the jobs that many people have today will not exist in ten years' time. The post discussed topics ranging from anyone that worked in the transportation industry not having a job because all cars will be automated to many types of doctors not working because you will have a chip in your arm that will detect diseases before either the patient or a doctor could diagnose them today. It gave, in many respects, a very Draconian view of the world—talking about how do we employ people in a world where the computers and the machines can do things better, faster and cheaper than anyone else can do them. That had us thinking about the topic of this article, because the comparative number of Google results one receives upon searching "artificial intelligence" plus most topics far outweigh the results regarding artificial intelligence and the Wealth Management space. The scarcity of the commentary on this subject made us start thinking about how artificial intelligence would impact the Wealth Management sector. In this article, we look at how certain areas of the Wealth Management sector may be affected by artificial intelligence.

What is artificial intelligence?

If one would ask 15 different people what "artificial intelligence" actually is, we think you would receive as many answers as people asked. According to various literature: artificial intelligence is the natural progression of the method in which computers think such that the programming is no longer "if, then" programming, but rather, it allows the computer to design and develop cognitive analysis based on the information provided such that, in effect, the computer learns based on past experiences and the

data presented in order to achieve a better result. In fact, artificial intelligence is not new; in many areas, it has existed in one form or another for nearly 30 years. Just using the legal workplace as an example, 40 years ago, 80 percent of what a young lawyer did was help figure out what the law was by researching the law, and then maybe 15 percent was being able to make the work concise. Today, 90 percent of the work is analysing and articulating the law and conveying it in a simple manner because the information can be found very easily online in a matter of seconds (well, perhaps not seconds, but minutes or hours).

So, how does this impact the Wealth Management sector? Well, we see a number of areas on which artificial intelligence will impact the Wealth Management space, particularly the legal side of it: (1) compliance; (2) cross-border regulatory issues; (3) suitability; and, (4) client interfaces.

Compliance

Probably no single area causes more frustration for clients and employees than the compliance function in a financial institution. First of all, many people perceive the relevant compliance questions to be rather technical and confusing. Second, it has become almost a rote form of information gathering and random checks to confirm that the information is, in fact, correct. Artificial intelligence will change that: it will be able to assess many issues like “world check” in a simpler and more efficient manner. Artificial intelligence will automatically search the Internet for data, and then obtaining items like passports, identity cards or utility bills will be the most minor of functions. However, artificial intelligence will allow everything to be referenced constantly and simultaneously by a computer that does not sleep and has full access to data at all times. This will have some significant benefits in the sense that it will shift the burden from the collection of the data to the analysis of it, thereby yielding a better result. Notwithstanding this, it may be possible that computers could, at some point, start assessing the probative value of the information, which could result in improper conclusions.

Take the example of the following fact pattern: a client who is well respected, but is in a highly regulated industry, may have been sanctioned by one or more regulators over the years. That result will give the appearance of a person who has significant issues, but in the effect, the weighting of the source or the significance of the source by such apparently adverse history may not be of value. We have a client who had some bad press, and, for us, inappropriately so. Unfortunately, sifting through the mass of data on the internet to locate meaningful information is extremely difficult, if not impossible, and a searching algorithm based upon artificial intelligence may lack the “human” heuristics necessary to yield appropriate results. Thus, artificial intelligence will have the benefit of making many forms of compliance more efficient, smarter and safer, but it will have certain negative consequences. Another area where this will also have a similar effect in the context of the common reporting standard. As more and more countries adopt the common reporting standard, and data gets shared between more and more entities, artificial intelligence should be able to sort the data, not only based upon where someone declares their tax residency to be, but also based on actual patterns of communication between the bank and the customer, to determine whether that residency information is correct and verifiable, or if change is needed.

Cross-border regulatory issues

To date, the monitoring of cross-border regulatory issues are designed by and dealt with through compliance. Regulatory schemes can certify what relationship managers are doing on a trip, a process used to mitigate exposure, and monitor a relationship manager’s minutes of calls and meetings. This is obviously a highly flawed system that only obtains a nominal amount of the information. Further, it is fully dependent on the relationship manager telling the truth, which may be inaccurately reflected in a file note.

With artificial intelligence, the system will be able to review and confirm information on a regular basis, to gather information from both direct and indirect sources as to what is happening, and to detect events taking place in such a way so that appropriate cross-border structures are ensured. However, the

problem that will continue to remain is that there could be misinformation gathered, which will require human clarification; nevertheless, this will be a major issue going forward.

Suitability

Suitability, that being the concept of what should be the types of products purchased by a client, will, of course, be impacted by artificial intelligence. Instead of being driven by what the client certifies, product offerings will be carefully tailored and specifically developed to mirror a client's risk appetite, based upon the client's actual purchases, actual conversations (as recorded online), and other written communications. Unfortunately, this may result in various differentials between the way the portfolio is invested versus how suitability may require. This, in turn, could actually lead to greater litigation in the future.

Client interfaces

Will the computer, particularly artificial intelligence, eventually replace the individual? While we would postulate no, because at the end of the day, artificial intelligence would need to be able to understand things like a child out of wedlock or a lover or other types of issues. Honestly, we do not know, but what is clear is that it will be quite a long time before computers can replace this natural function of individuals. However, there will be incredible pressure on many people to discourage the use of human beings and to replace them with a computer because the tax (and other) savings will be incredibly significant. Whether that happens in the short term or long term is a different issue.

Conclusions

It is hard not to believe that the emergence of artificial intelligence would greatly affect the Wealth Management space. However, the literature on this potential impact is actually quite scarce compared to the actual effect that it will have, including on many other banking sectors. This lack of robust discussion is not for the better because the more we discuss it, the better off we—the Wealth Management sector and society—will be. Indeed, it will have major consequences for legal and other regulatory issues facing the Wealth Management sector. It is time to begin the conversation.

Owning and disposing of works of art: A wealth management perspective from Switzerland – Part 1

by Tilla Caveng and Jacopo Crivellaro (Zurich)

The ownership and sale of works of art has frequently been a neglected aspect in the wealth management and planning associated with high net worth individuals. However, because of the distinctive features of a work of art as an investment asset, it can pose a number of challenges to the unadvised art collector. In fact, a work of art is frequently illiquid and difficult to dispose of in a sale, or distribute and divide as part of an inheritance. On the other hand, works of art can also be very valuable and easy to move across jurisdictions. In general, the ownership and disposition of a work of art raises a number of tax and non-tax considerations that should be carefully considered. In fact, questions ranging from the best ownership structure to the most advisable succession plan, considering the art collector's goals, are aspects that a wealth planner should carefully consider.

This article attempts to survey some important considerations from a Swiss perspective.

Building a collection: buying and selling

Upon selling works of art, residents of Switzerland, including non-Swiss nationals, could become subject to income taxation. In general, the extent of such a tax obligation depends on the status of the seller, i.e. whether the seller is considered, for tax purposes, to be an art collector or an art dealer. Art

collectors are generally exempt from an income tax obligation when selling art. This is because according to Swiss tax law principles, capital gains stemming from the sale of movable personal assets are exempt from income taxation.

On the other hand, art dealers generally have to pay income tax when selling artworks. However, when art dealers determine their taxable income they can – as opposed to art collectors – deduct losses incurred when selling works of art.

But when is one considered to be an art collector or an art dealer? A seller is generally considered to be an art collector, unless the art dealing is carried out in the form of self-employed activity. There is no concrete definition of what defines a self-employed art dealing activity, rather, it depends on the individual circumstances of the case. Relevant and non-cumulative criteria are the amount of sales and purchases each year[20], the duration of ownership, systematic and planned methods, expertise or professional proximity, and, in particular, the use of borrowed funds. In recent cases the Swiss courts have ruled that a sale at an auction may already be an indication of systematic and planned methods. Once the obligation to pay income tax is established, the actual income tax rate depends on the canton and even municipality in which the seller resides. Moreover, an art dealer will also be subject to Swiss social security contributions and the sales are potentially subject to Swiss Value Added Tax ("VAT") should the sales in a (calendar) year exceed CHF100,000.

In some cases, a sale of a work of art will occur abroad, for example at auction houses in London or New York. In this case, it becomes important for the art collector to determine whether the sales proceeds are subject to local tax and duties. In many countries, a non-tax resident is only subject to tax on income sourced to that state (i.e. the "source country"). It then becomes important to understand the local tax laws that determine the source of gain from the sale of tangible movable property. Double tax agreements may apply, and should be consulted. Furthermore, in connection with the purchase or sale of a work of art in a foreign country, the import or export of the work of art may trigger VAT or customs duties.

From the perspective of the buyer, the exact ownership structure is also an important consideration. Works of art may be purchased directly by the art collector or may be purchased by legal entities – such as companies, trusts or foundations. The income tax consequences arising from the purchase and the sale of a work of art by a legal entity should be carefully analysed, as they may differ significantly from the treatment awarded to a private individual.

Owning the collection

Art works can also become subject to cantonal wealth taxes. Whereas under certain circumstances singular works of art are considered to be household effects not subject to wealth tax, highly valuable works of art and art collections are usually taxable. Criteria for differentiation can be the reasons for acquiring the work of art (investment or home decoration), current use (decoration of the house or in storage) and insurance (art insurance or household insurance).

Moreover, where a work of art is owned by a separate legal entity – such as a corporation or a trust - the gratuitous display of the work of art in a private individual's home could, in certain cases, give rise to a constructive dividend or a distribution from the foundation or trust. This is a position that tax authorities have taken in other jurisdictions, and which could also be applied in Switzerland.

For taxpayers that relocate across different jurisdictions, transferring works of art can also trigger unwarranted tax implications: in particular, VAT and customs duties. However, a taxpayer that relocates to Switzerland may benefit from the household goods exemption. The exemption extends to Swiss VAT and customs duties. The definition of household goods is rather broad and should extend to

[20] Please note that under special circumstances already one sale/purchase could lead to a qualification as art dealer.

art collections[21]. To benefit from this exception the imported art works must have been held personally for at least six months, and must continue to be used in a personal capacity after the importation.

Similarly, art collectors should be aware that the growing trend towards greater disclosure and reporting may soon affect art collections. While the current information exchange systems – the United States' FATCA and the OECD's Common Reporting Standard – focus primarily on financial assets, it is not unforeseeable that in the future ownership of art will also be subject to greater disclosure and transparency requirements.

Disposing and transferring a collection

As an asset class, art has an extraordinarily long life expectancy. When purchased, a buyer will generally presume that the work of art will last for decades, if not centuries. For example, an art collector who has purchased an Old Master's painting certainly does not expect it to perish in the course of his own lifetime.

For this reason, inter-generational planning in the context of works of art assumes key relevance. An art collector should be aware of the tax and non-tax consequences of his passing. For example, his death may trigger succession laws that will govern how his art collection will be divided between his heirs, as well as estate or inheritance taxes.

In Switzerland, inheritance tax and gift tax are regulated on a cantonal and sometimes communal level. This means that there are significant differences depending on the domicile of the donor/testator. The transfer of works of art might be subject to inheritance or gift taxes provided the deceased respectively donor was tax resident in Switzerland. In the Canton of Ticino, the residence of the heirs or donees may also be relevant to determine potential taxation. However, the tax is imposed on the heirs respectively donees, irrespective of where they are tax resident. Swiss inheritance and gift tax apply to the worldwide assets of the donor/testator with the exception of non-Swiss real estate. Furthermore, transfers between spouses and - in most cantons (with the exceptions of Appenzell I.Rh., Vaud and Neuchâtel) – transfers to children are exempt from gift and inheritance taxes. Some cantons also exempt parents, siblings and domestic partners.

The importance of determining the proper ownership structure of a collection assumes greatest relevance at the time of death of the collector. If the collector held the works of art directly, upon his death the art will form part of his estate and will be distributed to his heirs or legatees according to the law that governs his estate. In an estate that is governed by Swiss law, the works of art will form part of the assets of the decedent's community of heirs and will then be divided into the applicable shares for the heirs. Disagreement between the heirs may lead to protracted litigation, and may ultimately determine that the collection will be parcelled out and divided between the various heirs.

In order to mitigate some of the adverse tax and non-tax aspects of holding a collection directly, a collector may consider transferring his collection to a trust or a foundation. However, from a Swiss tax perspective, a transfer to a trust may be treated as a transfer to a third party that is potentially subject to cantonal gift taxes. In other cases – depending on the powers that the settlor retains over the trust - the trust assets may be treated as part of the settlor's estate for inheritance tax purposes. In all cases, it is important to ensure that the local tax authorities are informed, and an appropriate tax treatment for the trust is determined prior to its settlement.

[21] Limitations may apply to wine and other spirits collections.

From a non-tax perspective, the transfer of works of art to a trust requires special expertise from the trustees. Unlike other asset classes – such as real estate (which can provide a reliable income stream), or bonds and equities (which can provide readily quantifiable performance indicators) – works of art are illiquid and their management is extremely difficult to monitor. Trustees should generally take a proactive stance in ensuring that the art is adequately stored and catalogued, insured and regularly valued by reliable experts. This requires some level of sophistication from the trustees, or coordination with an investment adviser that is knowledgeable in the field.

Conclusion

The ownership and disposition of works of art can pose serious challenges for the unadvised art collector. In particular, a number of tax and non-tax consequences result from the death of the art collector. Wealth planners and advisors should carefully consider the most appropriate ownership structure and succession plan when advising high net worth individuals with significant art collections.

Forthcoming Events

Switzerland

Geneva

Business Briefings

2 November 2016 (16.30)
Developments in Germany affecting wealthy families and their financial advisors
Speaker: Sonja Klein (Baker & McKenzie Frankfurt)

22 November 2016 (16.30)
New Era for Russian Wealthy Families: Update / Developments / Risks
Speaker: Sergei Zhestkov (Baker & McKenzie Moscow)

15 December 2016 (16.30)
UK Tax Developments in Perspective
Speaker: Stephanie Jarrett (Baker & McKenzie Geneva)

These business briefings will be held at Baker & McKenzie Geneva, 5 rue Pedro-Meylan, 1208 Geneva. For inquiries, please contact: ganchimeg.daali@bakermckenzie.com.

Zurich

Business Briefings

25 October 2016 (08:00)
Taxation of Trusts and Foundations from a Swiss Perspective
Speaker: Andrea Bolliger (Baker & McKenzie Zurich)

3 November 2016 (08.00)
Developments in Germany affecting wealthy families and their financial advisors
Speaker: Sonja Klein (Baker & McKenzie Frankfurt)

8 November 2016 (08.00)
Planning and Confidentiality in the Era of Automatic Exchange of Information: New perspectives on structuring family wealth
Speakers: Thomas Salmon and Gregory Walsh (Baker & McKenzie Zurich)

17 November 2016 (08.00)
Philanthropy for High Net Worth Individuals: structure choices and jurisdictions
Speakers: Kevin Keen and Jacopo Crivellaro (Baker & McKenzie Zurich)

24 November 2016 (08.00)
New Era for Russian Wealthy Families: Update / Developments / Risks
Speaker: Sergei Zhestkov (Baker & McKenzie Moscow)

13 December 2016 (08.00)
UK Tax Developments in Perspective
Speakers: Lyubomir Georgiev and Stephanie Jarrett (Baker & McKenzie Geneva)

These business briefings will be held at Baker & McKenzie Zurich, Holbeinstrasse 30, 8034 Zurich. For inquiries, please contact businessbriefings.zurich@bakermckenzie.com.

United States

Miami

27-28 October 2016
17th Annual International Tax and Trust Training Program
Venue: The Biltmore Hotel, 1200 Anastasia Avenue, Coral Gables, FL 33134

For inquiries on this event, please contact Susie Belanger at susie.belanger@bakermckenzie.com.

New York

Business Briefings

13 October 2016 (09.00)
All in the Family: The Proposed 2704 Regulations and Valuation Discounts
Speakers: David Berek (Baker & McKenzie Chicago), Glenn Fox (Baker & McKenzie New York) and Rodney Read (Baker & McKenzie Houston)

17 November 2016 (09.00)
Practical Common Reporting Standard Issues in Planning for International Clients
Speakers: Kathleen Agbayani (Baker & McKenzie Washington DC) and Paul DePasquale (Baker & McKenzie New York)

8 December 2016 (09.00)
Crafting the Protector
Speakers: Simon Beck (Baker & McKenzie Miami) and Kristy Balkwill (Baker & McKenzie New York)

These business briefings will be held at Baker & McKenzie New York, 452 5th Ave, New York, NY 10018. For inquiries, please contact megan.kerney@bakermckenzie.com.

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