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The Sacrifice of Financial Privacy

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Tax legislation evolves constantly and such evolution should be balanced against the backdrop of healthy international tax competition between countries. Introduction of new methods of taxation is just part of life. There is a new twist of tax legislation though, one linked to international cooperation rather than competition. This comes in the form of wide multilateral reporting standards with the stated aim of flushing out tax evasion and inhibiting tax avoidance or tax planning. My perspective is that of a professional trustee for international families who enjoy substantial wealth and who invest internationally: my remarks below are derived from seeing how problems can arise in practice from these new rules.

Since 2010, we have seen the introduction of specific French trust reporting rules for trusts, Swiss bilateral withholding tax agreements, FATCA, EU public registers on beneficial ownership, the Common Reporting Standard ("CRS"), trust registers in several jurisdictions (notably the UK and New Zealand), and beneficial owners of property registers. For the practitioner or professional it represents a near constant buffeting from constantly learning and implementing one new reporting requirement before the next one arrives.

In this fast changing world there remain some un-altering fundamental obligations that should weigh heavily on fiduciaries (such as trustees). The first one is the duty to put always put the interests of the beneficiaries first. The second is a duty of confidentiality, which may arise under specific legislation in certain jurisdictions or by reason of an express obligation in a trust deed, for example.

Preserving confidentiality is not the same as mischief-concealing secrecy. Our readers are undoubtedly reputable professionals amongst whom there will be zero tolerance for tax cheats. However, 'nothing to hide' is not in itself a good reason to give up information with which one has been entrusted. The law appears to draw a distinction between tolerable or permitted financial privacy: a journalist, like the rest of us, is entitled to keep details of his local bank balance confidential but he is not obliged, it seems, to respect privacy where ownership of private companies or real estate is concerned even though both are financial assets. A domestic bank may be obliged to deduct tax from interest payments and account for them to the local tax administration (as was the case in the UK until recently) but did not have to report balances on customers' accounts: under CRS if the account is held abroad then the balance would be reportable. Financial privacy is increasingly a domestic right only, and recognized in respect of certain assets only, it seems.

Consider the French trust reporting requirements introduced in effective from 1st January 2012 that required trustees that owned (whether directly or indirectly) French situs assets[i]. In my example, all the real estate taxes had been paid, none of the trust parties were French tax resident. In discussion with some of the beneficiaries, it was agreed that reporting was a price worth paying to avoid risking the trust assets with heavy penalties of up to 5% of the asset value for noncompliance. Rather than take the FATCA approach and simple require a declaration as to whether French tax residents were parties to the trust, the French Fiscal Administration demanded full details including names, residential addresses and dates and place of birth of all the trust parties (the trustees, settlor and all living members of the discretionary beneficiary class) together with the terms of the trust and valuation details of French assets. In this case, the disclosure was signed off with an express request to keep these details confidential. Having gathered this information over successive years, in 2016, the French Government declared that this information was going to be made public. To explain to a mother of pre-school children that their personal details were about to be published on an internet portal simply because their grandfather's appointed trustee had invested in French real estate twenty years previously even though they had no directly enforceable title to the real estate in question, is a very unhappy conversation. Fortunately, at the eleventh hour, the publication of the French public register for trusts was struck out as being unconstitutional on account that it breached a fundamental right to private life[ii]. Trust in governments to act responsibility with disclosed information had been badly shaken though. And this is a climate of opinion still influenced by the overreach of government into the private sphere as exposed by the Snowden Reports in June 2013.

But at least France is a constitutional democracy, and one can accept that it does face a problem with tax evasion. Is anyone able to enlighten me as to why Saudi Arabia is a participating jurisdiction of CRS? This is the CRS that the OECD 'designed with a broad scope in terms of the financial information to be reported, ... in order to limit the opportunities for taxpayers to circumvent reporting.' So, which Saudi Arabian taxpayers would those be? Before moving away from constitutionality, I am grateful to Filippo Noseda in repeatedly highlighting the OECD's flagrant disregard of the privacy rights enshrined in the European Convention on Human Rights and the EU Charter of Fundamental Rights[iii]. CRS also requires personal details of trust protectors to be disclosed alongside the value of the trust fund. Often close family or friends doing a favour, protectors as fiduciaries have no beneficial interest in the trust assets (unless – exceptionally - they are also beneficiaries), and consequently have never been taxed in relation to

them. On the 7th August 2017, the OECD boasted of some 2,000 exchange agreements concluded between 70 jurisdictions[iv]. That will be a truly enormous number of reports containing names, birth dates, bank names, account numbers and values (whether bank balances or values of trust funds and distributions) that will be released to governmental authorities. Many of those will go to countries for whom conventions on human rights do not weigh terribly heavily (and yet the OECD bemoans the fact that more developing countries do not exploit the opportunities afforded to them by information exchange more[v]).

Beyond the concern of government mishandling of information, there is the additional risk of financial institutions' mis-implementation. One of several bad experiences arising out of the Swiss/UK special tax agreement involved a misclassification of a company that was wholly owned by a discretionary, irrevocable trust, lacking any reserved powers (as had been confirmed to a particular Swiss bank to ensure - we hoped - that it understood that it was out of the scope of the agreement). Notwithstanding, the company received a letter stating that its bank account was shortly to be relieved of a sum in the high hundreds of thousands of pounds, representing the equivalent amount of historical income and capital gains tax that would be paid by the Swiss bank to its authorities and then on to HMRC. The explanation? 'Because the b/o is domiciled in the UK.' The 'b/o' referred to one of the discretionary beneficiaries of a non-settlor interested, excluded property trust. The beneficiary was non-UK domiciled, and taxed on a remittance basis. 'Domiciled' had been applied as a translation from the French for 'resident' and any real understanding of the facts lost. The example highlights the weaknesses of reporting agreements in which tax authorities marshal foreign bankers as *tax collectors* and not just as information agents. Following the end of this particular agreement on 31st December 2016, one must hope that such tax collection approaches will never be adopted again in the future. Assets had been put at risk and, again, we saw significantly prejudiced personal interests of a foreign citizen with no outstanding tax liabilities.

Effective and more integrated approaches to root out tax evasion are welcome: mutual assistance with tax enquiries seems entirely reasonable and one could imagine the effectiveness of the CRS network in responding to requests for information to assist in tax enquiries. The current blanket approach to exchange of information does seem problematic though. Reporting information that the fiduciary unequivocally knows has no relevance for the recipient tax authority (protector details, for example), runs the risk of being used in other ways and is difficult to justify in terms of core fiduciary obligations.

Assuming that such global reporting and transparency initiatives are now part of the landscape, what, if any, practical steps might fiduciaries take to balance their obligations?

Beneficiaries of fiduciary care should have fair notice of not only any forthcoming new reporting standards, but also any personal information that will be released. Jurisdictional arbitrage will favour countries that have legislated more practically and comfort may be taken in dealing with 'late adopters' who have observed reporting in other jurisdictions. Most will rationalise that the benefit of investing in a certain jurisdiction is worth the giving up of personal details. If objections are raised, different options according to each case must be thoroughly assessed, ultimately putting the beneficiary's best interests at the centre of the decision. Again, this is not about constructive assistance with regards to hiding money. It

is not about activity looking for loopholes to circumvent the legislation, but there may be choices to be made as to how and where private capital is invested in future.

Enquiry should be made with the financial institutions that hold the assets in order to be clear as to how they are to implement the reporting. Choose institutions where one can establish a reasonable two way dialogue with people who possess influence (many relationship managers appear to be powerless to fight for their clients). As a minimum, confirmation as to which assets fall in scope with any reporting regulations should be unambiguously received in good time before the reporting. Information exchange is problematic enough without multiple financial intermediaries erroneously duplicating the same report.

To conclude, various transparency laws with the stated goal of combatting tax evasion and other illicit flows have gathered momentum with astonishing swiftness over the last few years. While the policy objectives may be sound, implementation should give pause for thought to the conflicting issues that surround them and how best to serve our clients in this environment. Transparency currently looks here to stay requiring sensitive application by practitioners. I cannot finish without reaching for the OECD's byline, "Better policies for better lives". And who could disagree with that? Transparency has a role to play, but so too has fair and respectful policy.

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[i] With the exception of French quoted financial assets.
[ii] *Re Helen S, decision n 2016 - 591 QPC dated 21 October 2016*
[iii] Trust & Trustees, June 2017 'CRS and beneficial ownership registers - what serious newspapers and tabloids have in common.
[iv] http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/
[v] The OECD's Global Forum on transparency and exchange of information for tax purposes conclusion.