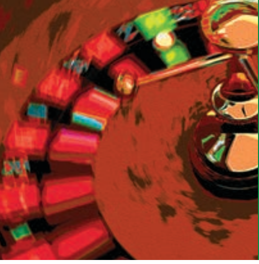


YEAR IN REVIEW:
INTERNATIONAL PRACTICE

By Barbara R. Hauser

The Year of Transparency's Tipping Point

More countries are requiring an exchange of client information

In 2014, we saw a marked increase in transparency regarding foreign assets. The United States took the lead, and other countries followed suit. It looks like we've reached the tipping point, that is, "the magic moment when an idea, trend, or social behavior crosses a threshold, tips, and spreads like wildfire."[1]

United States

The United States spearheaded the global attack on secret or private financial accounts. The implementation of the Foreign Account Tax Compliance Act (FATCA) changed the world of private wealth. The purpose of FATCA (an incredibly complicated and detailed piece of legislation) is to require all banks (that is, "foreign financial institutions") in the world to report (directly or indirectly) to the United States the information about accounts that might be owned (directly or indirectly) by U.S. taxpayers.

FATCA, enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, was greeted in the international community with disbelief and outrage.[2] But, the United States persevered, and FATCA (after a number of postponements) is now going into effect. Amazingly, nearly all countries have gradually agreed to comply with FATCA. Now global clients (who are U.S. taxpayers) are scrambling as they learn that their bank accounts will be reported to the United States.

Switzerland

The days of the revered "secret Swiss bank account" are over.[3] Switzerland experienced the most change in 2014, in part due to the spread of FATCA and the gradual creep of global transparency. FATCA comes on the heels of attacks by the United States directly against Swiss banks, beginning with UBS.[4] After its success against UBS (and other Swiss banks), the United States has put Swiss banks in one of four categories: (1) those already under investigation; (2) those that have probably not previously reported their U.S. account holders; (3) banks without undeclared U.S. clients that are applying for confirmation from the U.S. Department of Justice that they're not being investigated; and (4) Swiss banks with only local clients.

With the Swiss financial sector undergoing far-reaching reforms, some political movements in Switzerland are considering increases in taxes, including the possible introduction of a national inheritance tax (which has been left to each canton traditionally.)

The Swiss tax system is currently undergoing radical changes on all fronts. Here are some of the highlights.

International exchange of client information. In 2014, the Swiss financial industry kept busy with a comprehensive process of regularization of its past. The main focus was on the United States. More than 100 banks applied for "Category 2" of the U.S. Justice Department's Non-Prosecution Program for Swiss banks (Category 2, as explained above, is for banks that have reasons to believe that they have committed tax-related offenses). Further, Swiss financial institutions began to implement FATCA.

The next big issue for banks that looms on the horizon is the Automatic Exchange of Information. During the summer of 2014, the Organisation for Economic Co-operation and Development (OECD) issued its Model Competent Authority Agreement and the Common Reporting Standard, as well as the relevant commentaries. Switzerland has committed to

Barbara R. Hauser is an independent global family advisor based in Minneapolis

implementing the new exchange standard from 2018 forward.

On Nov. 14, 2014, the Swiss government decided to join the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information. It already signed the multilateral OECD/Council of Europe Convention on Mutual Administrative Assistance in Tax Matters in 2013. Both instruments will be part of a larger political consultation process in Switzerland in 2015 before they're ratified.

Lump sum taxation. Various cantons have had a policy of negotiating a fixed tax (a forfait or lump sum) for wealthy individuals intending to reside in Switzerland. Local residents have protested this policy in a number of cantons. A popular vote was held on Nov. 30, 2014 on a proposal that required the repeal of lump sum taxation of qualifying individuals. Just as we went to press, the Swiss voted to uphold forfait (on a cantonal basis).

Lump sum taxation of certain individuals has been subject to controversies in Switzerland in the last few years. Various cantons recently abolished this privilege (for instance, Zurich), while others introduced stricter rules (for instance, Berne). If lump sum taxation is maintained as a means to offer attractive tax conditions to certain foreign taxpayers, the minimum requirements will become somewhat more restrictive: Among other requirements, a minimum tax base will be introduced (usually it will amount to a taxable income of at least CHF 400,000). Experience shows that the specific requirements and thresholds that must be satisfied by non-European Union citizens to benefit from these rules have generally been increased.

However, lump sum taxation also has become an interesting immigration planning tool for non-Swiss high-net-worth individuals. If, on Nov. 30, a majority had been in favor of repealing lump sum taxation, individuals who've been benefitting from it so far would have become subject to ordinary taxation after three years.

National estate and gift tax. Another popular vote that's expected to be held in 2015 will be about the potential introduction of a national estate and gift tax. According to the proposal, transfers of property at death or by gift would be subject to a new flat tax of 20 percent of actual value at the time of the transfers (with an exemption for the first CHF 2 million). Transfers among spouses and registered partners would be exempt. No exemptions or privileges would apply to direct descendants.

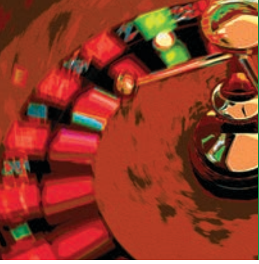
The proposal also contains a problematic retroactive effect: Any gifts made after Jan. 1, 2012 would be added to the taxable estate at the time of the passing of the decedent and be subject to the tax.

Under the Swiss government's proposal, capital gains from the sale of securities would, in part, be included in an individual's taxable income.

Capital gains taxation. Finally, in September 2014, the Swiss government issued a proposal for a comprehensive reform of the Swiss corporate tax system (the Corporate Tax Reform III). The purpose of the reform is both to increase the international acceptance of the Swiss tax system and enhance Switzerland's attractiveness for multinationals.

Part of the proposal is directly relevant for individuals, as it includes the introduction of a capital gains tax on the disposal of privately held securities. Currently, capital gains from the disposal of any privately held assets are tax-free (exceptions are made for real property). Under the new rules, capital gains from the sale of securities would, in part, be included in an individual's taxable income.

Furthermore, leaving Switzerland would be treated as a sale; therefore, it would also constitute a taxable event



on the basis of a deemed capital gain. Limited deferral would be available in the case of an inheritance. Capital gains taxation has always been a highly controversial topic in Switzerland. It's therefore questionable whether such a tax will effectively be introduced.

France

France continues to try to raise revenue through a variety of taxes that apply to wealthy individuals. At the same time, anecdotal evidence suggests that wealthy families are continuing to leave France (often relocating to London, with its "tax holiday" rules). France is considering how to tax trusts, even though the French legal system doesn't recognize them.

The French legislation causes tremendous worries for international families and innumerable questions for their trustees and advisors.

Since 2011, international families with French residence and/or French-situated assets have had to face the new French tax legislation on trusts adopted in July 2011, which took effect for inheritance and gift tax purposes on July 30, 2011 and for wealth tax purposes on Jan. 1, 2012. The legislation still causes tremendous worries for international families and innumerable questions for their trustees and advisors. The statutory provisions are difficult to understand, and there's not much useful guidance from the French tax administration. The tax legislation on trusts provides a broad definition of trust, trustee, settlor and beneficiary. It applies indifferently to inter vivos, testamentary, discretionary or non-discretionary and revocable or irrevocable trusts.

For the purpose of applying the trust legislation, a beneficiary becomes a deemed settlor when the original settlor dies, and the second beneficiary also becomes a deemed settlor when the first deemed settlor dies, so that each generation is subjected to tax.

Subject to the application of tax treaties, French Inheritance Tax (FIT) is to be paid on the trust's assets when the settlor or deemed settlor is a French tax resident at the time of his death (or gift) or when a beneficiary is a French resident at the time of death (or gift) and has been a French resident during at least six of the last 10 years. In other cases, FIT is to be paid on only the French-situated trust assets. A complex set of rules provides for different rates to apply depending on the nature of the beneficiaries (descendants or not) and the array of discretion given to the trustees. This may result in descendants or spouses paying a much higher tax when assets are transferred through a discretionary trust compared to assets transferred directly to them.

Subject to tax treaties, the new trust legislation subjects settlors and deemed settlors to the French wealth tax on the worldwide net trust assets when the settlor is a French tax resident or on French-situated trust assets when the settlor or deemed settlor isn't a French resident.

France also levied a new "sui generis" tax. Its aim is to claw back trust assets that weren't reported in a wealth tax return and subject them to the highest rate of tax. It's to be paid by settlors or deemed settlors.

The new trust legislation provides for a compulsory annual disclosure requirement by trustees, which if not fulfilled, will trigger substantial penalties. Reporting requirements exist as soon as one of the following criteria is met:

- the settlor or deemed settlor is a French resident on January of the current year,
- one of the beneficiaries is resident in France on Jan. 1 of the current year, or
- one of the trust assets is a French-situated asset.

The creation or modification of an existing trust must also be reported.

Failure to report and disclose is punished by a penalty of 5 percent of the trust assets with a minimum of EUR 10,000. The French tax administration has issued forms that must be used for the filing.

Expert French tax advice must be sought as soon as a settlor, deemed settler or beneficiary of a trust is a French resident or if French assets are included in trust

assets.

Hong Kong

Hong Kong is also dealing with the disclosure pressures from the United States. Christian Stewart, founder of Family Legacy Asia (HK) Limited in Hong Kong, reports that Hong Kong has entered into an agreement with the United States for the exchange of taxation information on request. This agreement is effective from June 20, 2014.[5] Hong Kong has also committed to enter into a Model II Intergovernmental Agreement with the United States to implement FATCA.

The Mansion Tax

As private wealth has been moving from home country to investment countries, the local economic impact is also annoying the residents of those investment countries. Local residents have complained that they can no longer afford to live in their home city.

The enormous increase in the prices of residences in prime locations in, for example, London, Hong Kong and Singapore, have prompted new local taxes on "mansions" aimed at foreign buyers

Britain. The London mansion tax has been proposed since 2010 and has become a hot political topic. It would apply on an annual basis to homes valued in excess of 2 million GBP. A version of it might be passed in the 2015 elections. Meanwhile, beginning in 2015, Britain will impose a new capital gains tax on the sale of residential property owned by foreign investors. As the law firm Farrer & Co comments, this is "a bid to tackle a feared property bubble apparently driven by Russian oligarchs and Indian or Middle Eastern tycoons pricing Londoners out of the market."[6]

New York. A mansion tax is also appealing to New York, which has similar issues. As reported recently in the *Wall Street Journal*:

> A fear of annual mansion taxes on the wealthy, many of them foreigners, is causing ripples in luxury housing markets on both sides of the Atlantic.
>
> In London, an Italian hedge-fund executive withdrew an offer a few weeks ago for a 4,000-square-foot home in the prime Knightsbridge neighborhood listed for about £20 million ($32 million).
>
> He was worried, said his broker, … about a proposal floated by the opposition Labour Party to raise nearly £1.2 billion ($2 billion) through a new annual tax on the value of high-price homes.
>
> In New York City, [one] broker … said she saw a sale fall apart between her Brazilian buyers and the owner of a $30 million Park Avenue co-op.
>
> The breakdown, [she] said, followed remarks by Mayor Bill de Blasio that he was evaluating a plan to impose an annual property-tax surcharge on expensive pied-a-terres.
>
> "The buyers have been advised by their financial people that it is not wise to proceed while this in on the table," she said.[7]

Hong Kong. Its version of a new mansion tax increases the stamp duty (a real estate purchase tax) on the purchase of expensive homes and apartments.[8] Stewart reports that stamp duty measures have been introduced that are intended to prevent speculation in Hong Kong residential properties,[9] including a 15 percent Buyer's Stamp Duty, which applies when property is purchased by any corporation or individual other than a Hong Kong permanent resident, and a Special Stamp Duty.

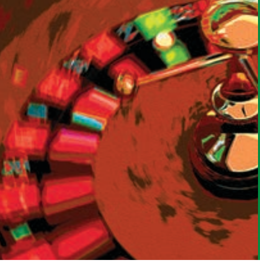
Family Inheritance Disputes

On a different note, but still on the theme of the vast increase in transparency, Stewart reports that the big news in Hong Kong for wealthy families continues to be spectacular ongoing public family inheritance disputes.

In 2014, for example, the Fok family was still at each other. Henry Fok Ying-tung had 13 children with three wives. When he died of cancer in 2006, *Forbes* estimated his fortune at $3.7 billion (USD). He built his estate on mainland investments and was a vice-chairman of the Chinese People's Political Consultative Conference.

In August 2012, at least 17 family members reached a settlement over the multi-billion-dollar estate. Benjamin Fok Chun-yae, his brother Ian Fok Chun-wan and their aunt Fok Mo-kan were appointed executors.

The family just didn't end their court battles. In 2014, the two youngest children by Henry's first wife tried to reopen the settlement. The judge called their attempt "deplorable litigation" and ordered the two of them to pay the unspecified costs of the other 15 family members in the case.[10] The entire family fighting history was



public once again.

Stewart notes: There's a Chinese saying, "Parents in Heaven; Children in Court."

—The author thanks and acknowledges Marnin Michaels (partner) and Robert Desax (associate), at Baker McKenzie in Zurich for their contributions to the Switzerland section and Anne Guichard, a notaire and partner at Gilles, Ceyrac, de Burhen, Montes, Bigot, Guichard, Lucas in Paris, for her contributions to the France section.

Endnotes

1. Malcom Gladwell, *The Tipping Point, http://gladwell.com/the-tipping-point/.*
2. *See, e.g.,* Lynne Swanson and Victoria Ferauge, blog (July 28, 2013), "FATCA: 'Simple premise' gone terribly wrong," *http://thehill.com/blogs/congress-blog/foreign-policy/313775-fatca-simple-premise-gone-terribly-wrong:*

   > . . . how did the 'simple premise' of 'cracking down on illegal tax evasion and closing loopholes' become an attack on financial lives and personal integrity of millions of people living outside United States, their banks and laws and constitutions of their countries of residence?
3. Switzerland has been referred to as a $2.3 trillion global hub for cross-border banking. *See www.bloomberg.com/news/2014-07-31/swiss-banks-send-u-s-client-data-before-cascade-of-settlements.html.*
4. See a number of previous technical articles on the Foreign Account Tax Compliance Act and on the attacks on Swiss banks, in *Trusts & Estates*.
5. *http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/treaties.aspx*
6. *Farrer Review 2014,* at *http://view.digitalissue.co.uk/00000082/00008121/00089812/.*
7. *http://online.wsj.com/articles/london-has-mansion-tax-lessons-for-new-york-1412384346.*
8. Singapore had earlier adopted a similar tax. *See www.ft.com/intl/cms/s/0/b1e683a4-6ef4-11e4-b060-00144feabdc0.html#axzz3K588hgO4.*
9. Hong Kong has been named as the single most expensive place to buy an apartment. *See www.bloomberg.com/news/2013-02-22/hong-kong-doubles-stamp-duty-on-all-properties-on-bubble-concern.html.*
10. *See www.scmp.com/news/hong-kong/article/1524777/fok-heirs-bear-costs-row-over-hong-kong-tycoons-multi-billion-estate.*