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Baker McKenzie - Recent Updates Affecting the Wealth Management Industry - Taiwan

As the world attempts to return to something resembling normal, Baker McKenzie shares the things that wealth management industry players need to be aware of in the local market of Taiwan. Asia Pacific Chair Michael Wong, Partner Peggy Chiu and Associate Daniel Chou give insights into incoming CFC legislation, the role of charitable trusts, the scope for securities companies, and elucidate on the 'Taiwan Trust 2.0' proposition.

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THE TAIWAN CFC RULES ARE AROUND THE CORNER

Taiwan has a controlled foreign corporation (CFC) regime. The CFC legislation is scheduled to come into effect in 2022.

When does CFC dawn on Taiwanese billionaires?

The CFC rules, which has been incorporated into Article 43-3 of the Income Tax Act since July 2016 and Article 12-1 of the Income Basic Tax Act since May 2017, has not come into effect yet. However, the status quo might change in the foreseeable future.

In October 2020, the Minister of Finance announced that the tax amnesty legislation to encourage fund repatriation back to Taiwan will expire in August 2021 as scheduled, and will not be extended. Pursuant to the ancillary resolution passed by the Legislative Yuan, the CFC rules are to come into effect within one year after the tax amnesty legislation expires. It is expected that the CFC rules will come into effect in 2022 at the earliest.

There is currently no scheduled effective date for the place of effective management regulations, which were introduced to prevent tax evasion.

How do the CFC rules impact on estate planning?

Once the CFC rules come into effect, the traditional method of shifting profits from a home jurisdiction and retaining them in a foreign company located in a jurisdiction with lower-tax burdens might become less viable from a tax planning point of view.

Under the CFC rules, if a parent company holds 50% or more of shares in its foreign subsidiary, or has significant influence over the foreign subsidiary, the subsidiary may be deemed to be a conduit and be regarded as a look-through entity from a tax perspective unless the subsidiary satisfies the substantial activity test or its revenue is below the stipulated threshold.

Considering the potential CFC risks, we suggest conducting a comprehensive review of existing or planned structures, and making the necessary adjustments as early as possible.

CHARITABLE TRUSTS ARE TO BE USED SOLELY FOR CHARITABLE PURPOSES, NOT AS FAMILY TRUSTS

The Foundations Act was announced in 2018 to prevent a foundation from being used as a family shareholding vehicle while on the face being designed for charitable purposes. After the Foundations Act was implemented, the public spotlight shifted to charitable trusts, which have long been playing a role similar to that of foundations. Charitable trusts were regarded as a loophole for owning family assets after the Foundations Act became effective.

The Executive Yuan approved the draft amendment of the Trust Act on 22 April 2021. Mirroring the Foundations Act, this amendment fixes a new threshold for minimum yearly charitable spending and total cash ratio when setting up a charitable trust. In addition, it prohibits the acquisition of shares of listed companies constituting more than 5% of the total trust property, and the holding of over 5% shares of a single company. Last but not least, when a charitable trust is terminated, the trust property may only devolve on a charitable legal person, a charitable trust, or the Government.

A key take-away is that, in the past, families might have used a foundation or charitable trust to hold shares and run a family office; however, nowadays, foundations and charitable trusts may be used solely for philanthropy purposes.

IT IS EASIER TO DO WEALTH MANAGEMENT BUSINESS IN TAIWAN WITH A SECURITIES LICENSE

The Taiwanese Government has opened the door for securities companies to conduct wealth management business. This will provide offshore banks with a less costly approach to upscale their capabilities to offer planning options to Taiwanese clients.

Instead of getting a banking license or being exposed to cross border financing risks, a third option may be viable for doing wealth management business in Taiwan.

In an example scenario, XYZ Bank wants to sell its Taiwanese consumer banking business and carry on a

wealth management business offshore from an Asian hub, like many of its competitors in the US, Europe, Hong Kong and Singapore. It is following the path of its peers from ten years ago, but has it foreseen the difficulties and compliance risks ahead of this journey?

For historical reasons, many Taiwanese clients have great wealth offshore, and offshore banks have helped manage this wealth for decades. When the world became more transparent and anti-tax avoidance measures such as the common reporting standard, economic substance rules and the CFC rules were introduced, offshore banks faced higher compliance risks and domestic banks started competing more fiercely. Offshore banks are generally more sophisticated and can provide diversified investment products. Domestic banks, on the other hand, can provide holistic solutions from funds flow to succession planning, if they learn fast enough to make up the past few decades' lost experience.

While domestic banks are expanding and learning, is there a way for offshore banks to obtain a competitive advantage by enhancing their capabilities for providing holistic solutions? Based on our observations, the two missing puzzles for a holistic solution to be offered by offshore bankers for succession planning are funds flow solutions and the offering of onshore trust structures. It is not the potential revenue arising from these two pieces that matters, but the risk of losing clients going elsewhere to seek such solutions and affecting the whole business.

Offshore banks can apply for an onshore banking license (which requires around USD 300 million of capital injection) or an onshore trustee license (which requires around USD 71 million of capital injection), but the cost may be too significant for these options to be seriously considered. Now, offshore banks are provided with a more economical option – the securities license.

How can a security license assist in starting and carrying on a wealth management business?

Option 1: Partner with a local securities company. In March 2021, the Financial Supervisory Commission (FSC) issued a new amendment to the Regulations Governing Borrowing or Lending Money in Connection with Securities Business by Securities Firms. Foreigners (including Taiwanese clients registered as foreign investors) may use foreign currencies as collateral when obtaining NTD loans from securities brokers to invest in the Taiwanese securities market. This implies that a securities broker (for which the required capital is USD 7 million) can facilitate in-flow funding needs, similar to the Wai Bao Nei Dai (i.e., 外保內貸 or the offering of onshore credits secured by offshore deposits) provided by domestic banks. If an offshore bank wants to provide in-flow funding options to its clients, instead of partnering with an onshore bank to offer Wai Bao Nei Dai, it can now partner with a securities broker that does not itself have a wealth management business to reduce the potential business conflict and client poaching risks.

Option 2: Become a securities company in Taiwan. To go one step further, instead of finding a partner, an offshore bank may buy or invest in a small securities brokerage firm in the Taiwan market, or even set up a securities broker on its own to facilitate the carrying on of a Wai Bao Nei Dai business. Potential small and low-cost acquisition targets exist in the market.

Option 3: Become a securities company in Taiwan and apply for a high net worth business license. To completely eliminate cross border financing risks, if

an offshore bank owns a securities broker in Taiwan, it can apply for a license to carry on a high net-worth client business in Taiwan, and such a broker may provide trustee services as well. The FSC announced new rules in August 2020 to allow a securities company to apply to carry on a high net-worth client business through a securities license (instead of a banking license). (A high net-worth client is a client with total assets exceeding NTD 100 million, i.e., around USD 3.5 million.) At the end of 2020, the FSC approved four such applications of securities companies. It is estimated that there are 10 securities companies that are qualified to make such applications.

The threshold for setting up a securities company is much lower than that for setting up a bank in Taiwan to carry on a private banking business. As such, applying for a security license may be a soft landing solution for offshore banks to carry on a wealth management business in Taiwan. That said, offshore banks need to approach a legal adviser to consider in detail the requirements and assess the feasibility of this option.

TAIWAN TRUST 2.0 – AN OPPORTUNITY OR THREAT TO OFFSHORE ECO-SYSTEM PLAYERS?

Offshore eco-system players (e.g., bankers, independent trustees, and insurance brokers) generally find domestic wealth management developments either irrelevant or a threat to their wealth management businesses. However, the Trust 2.0 proposed by the FSC may provide an opportunity for offshore eco-system players in Taiwan.

The FSC is promoting Trust 2.0 to lower the capital requirement for independent trustees, which may be a great opportunity for offshore bankers

The Trust 2.0 proposed by FSC will be a two-year project, starting in 2021. One of the goals of Trust 2.0 is to build more friendly legal and tax regimes for family trusts to provide diversified succession tools to wealthy families. Additionally, the FSC is encouraging the establishment of specialized private trust companies (PTCs) because current onshore trust options are all provided by a bank's trust department, which are subject to heavy banking regulatory burdens and lack the flexibility to set up new trust structures. The FSC will explore the feasibility of specialized PTCs starting in December 2021, and family trusts in September 2022.

How is this relevant to the offshore wealth managers?

Currently, onshore trust structures are offered by onshore banks as part of a succession planning option (of course, this will also ride on the investment products of these onshore banks). Offshore banks are unable to offer similar services to their clients who have onshore trust needs – they can't offer the service and can't find a local partner, because the only possible partners are existing bank competitors. However, if the capital requirement for an independent trustee is lowered, there will be independent trustees in Taiwan who can work with offshore banks, and enable offshore banks to offer onshore trust structures as part of a holistic solution for clients' needs.

With Trust 2.0, it may be possible for Taiwan to have a (US compliant) foreign grantor trust or a PTC (along with a special purpose trust) set up by an independent trustee at a fixed annual fee. Assuming we are in a transparent world, these onshore trusts will be more tax efficient and have less setup costs. How the onshore trustee can share fees with an offshore bank is another issue, which may also need to be considered.

Whether Trust 2.0 will be an opportunity or threat to offshore players really depends on a contest of speed – the speed of offshore players finding the easiest way to secure a seat in the Taiwanese market versus the

speed of onshore players learning and expanding their capabilities. Our guess is that if the Trust 2.0 amendment allows the capital requirement for a trustee of a family trust to be lowered to USD 10.7 million (as opposed to around USD 71 million now), several new independent trustees will emerge in the market.

Under the current law, trustees with a USD 10.7 million capital can only cover real estate trusts.

How are onshore players learning and expanding their capabilities? The implementation of the new wealth management rules

At the end of 2019, the FSC announced the new wealth management rules, which are aimed at developing Taiwan to become an Asian financial and asset management hub. The new rules focus on broadening the scope of permissible businesses for financial institutions to attract more high net worth clients.

On 7 August 2020, the FSC activated a new business item by implementing regulations enabling an onshore commercial bank's domestic banking unit (DBU) to provide specific financial products or investment services to its high net worth clients, such as foreign-currency-denominated structured notes or other indices in the local equity market. These financial products or investment services used to be offered only by offshore banking units (OBUs) as such investments are considered riskier. As of February 2021, the FSC has granted three local banks permission to launch this special wealth management program. Six other banks' applications were rejected.

CRS IMPACT AND RELATED TAIWANESE DEVELOPMENTS

The Regulations Governing the Implementation of the Common Standard on Reporting and Due Diligence for Financial Institutions (CRS) have been in effect since 2019. These authorize the Ministry of Finance (MOF) to request financial institutions to conduct due diligence on their clients and collect relevant information for tax purposes. Pursuant to existing tax treaties and agreements with other foreign governments, the MOF can exchange such tax information with foreign governments.

Taiwan completed its first tax information exchange with Japan and Australia in September 2020. The MOF has revealed that the total account balances under tax information provided to Japan and Australia are NTD 954.8 and NTD 106 billion respectively, and the total balances under tax information it received from Japan and Australia are NTD 23.5 and NTD 94.1 billion respectively. In addition, the UK joined Taiwan's CRS network in January 2021, becoming the third jurisdiction following Japan and Australia that exchanges tax information with Taiwan. The first exchange between the UK and Taiwan will be conducted in September 2021.

Furthermore, it is worth noting that the scope of exchanged information in 2021 will expand and include not only high value pre-existing individual accounts" (over US$ 1 million) and pre-existing entity accounts", but also lower value pre-existing individual accounts" (below US$ 1 million). As a result, the volume of tax information that is going to be exchanged this year will grow significantly, and it is foreseeable that there will be more account holders covered and impacted by this change.

WEALTH MANAGEMENT DISPUTE CASE UPDATE

Battle of inheritance under a nominee agreement

Mr. Yin (穎川建忠), the former chairman of a listed company (i.e., Vewong (味王)) in the food industry and an influential shareholder of one of the biggest media companies in Taiwan (i.e., Formosa Television), owns hundreds of billions of NTD worth of assets, including multiple investments in aviation renting, hotels and other businesses across Taiwan and Japan.

When Mr. Yin's father passed away, Mr. Yin witnessed and took part in the fierce inheritance battle with his brothers. To avoid this kind of tragedy from happening in his family, Mr. Yin registered his assets and shares under the names of his children and his confidant, Mr. Chen. However, he did not expect that such arrangements would not stop his successors from engaging in their own inheritance battle. The battle intensified after he was diagnosed with dementia in 2016.

One side of the family argued that, by registering the assets and shares under the names of his children and Mr. Chen, Mr. Yin had distributed his legacies. The other side of the family argued that those registrations were the result of nominee agreements and those nominees, including Mr. Chen, should return the assets to Mr. Yin, whereby they would form part of Mr. Yin's estate.

The battle further escalated to the courtroom. In 2020, one of Mr. Yin's sons, on behalf of Mr. Yin, sued Mr. Chen for the return of shares registered under his name in connection with a nominee agreement. The district court dismissed the case on procedural grounds. However, the High Court reversed the district court's decision. Although the case is still pending, it is inevitable that the court will look into the substance of the arrangement. Sooner or later, the dispute will focus on the nature of the legal relationship between Mr. Yin and the asset holders (i.e., are there any nominee agreements between them, and what is the legal effect if there are nominee agreements?).

Main difference between a trust relationship and a nominee relationship

Except for the purpose of passing on wealth like in Mr. Yin's case, in practice, it is common to see asset owners register their assets under another person's name in order to control their businesses, reduce tax burdens or for other wealth management purposes. However, once the principal passes away or becomes incapable, the question of whether those assets registered under another person's name should be part of the principal's estate has generated numerous disputes between successors and asset holders. Typically, the main focus of a dispute is whether there is a nominee agreement between the principal and the asset holders, or whether the legal relationship is a trust arrangement.

Key takeaways

The validity of nominee arrangements is a long standing issue in Taiwan. Court decisions as to whether nominee arrangements are valid, legal and binding on a third party have been inconsistent. Whether a nominee arrangement can be treated as giving rise to a trust is a legal issue to be determined. Notwithstanding, offshore bankers can focus on this issue as a way to start succession planning conversations. We believe that the reason why a client chooses one bank over another in the course of succession planning is the client's confidence in whether the bank can solve this issue, as well as other issues such as the application of the CFC rules, while providing a holistic succession planning solution. ■

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