The Possible Implications for UHNWIs as a Global 15% Minimum Corporate Tax Draws Near

In mid-2021, the G20 agreed to a major move to transform global corporate taxation based on a directive to introduce the new 15% minimum effective tax rate for companies with revenues in excess of EUR750 million, with the aim of catching in this new net the overseas profits of all such companies, with the introduction planned for 2023. Some 137 countries have agreed to become signatories, and the European Commission in late December effectively ratified this by proposing a law that would implement it in the European Union, including the plan for a common set of rules on how to calculate the globally agreed 15% effective tax rate, so that it is consistently applied by member states. The big picture is that countries can still actually set whatever taxation rate they like, but if the rate is set at below 15% then the home country of the company (where it is registered) can – and indeed according for example to the European Commission, should – then top up the tax to 15%. The aim is apparently to eliminate profit shifting from high tax countries to low/no tax countries. But what could the implications be for the world of wealth management and should UHNWIs and families and advisors be looking at these moves closely, perhaps right now? To highlight some of the issues, Hubbis assembled a group of experts for a private discussion held in December, supported by our exclusive partner, The International Stock Exchange-listed independent financial services group PraxisIFM. Hubbis has distilled some of the more pertinent comments and insights below.

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THESE ARE SOME OF THE QUESTIONS AND CONCEPTS ADDRESSED IN THE DISCUSSION:

- Is it simply too early to determine the implications, especially as there are numerous different tax rates around the world and diverse accounting rules, for example around permitted deductions and the ensuing tax treatment of the resultant profits?
- However at least hypothetically, can one assume that within a few years from now that the G20/EU/OECD will widen the net and apply this model to all overseas companies, including personal investment companies (PICs), potentially family offices, or other family-linked investment vehicles?
- Hypothetically again at this stage, what impact could this have on wealth structuring and family offices and on the financial advisory industry?
- Would it matter if the vehicle were owned by the family members personally, or through a trust, or through a foundation, in other words from an onshore perspective, does the jurisdiction 'look through' trusts to the settlor/decision-makers/beneficiaries?
- If not, would this encourage families to hold these vehicles through trusts or other holding entities?
- What about offshore jurisdictions such as in the Caribbean? For example, will these developments (current and hypothetical) lead to changes in taxation and changes in the approach to structuring? Will it spell yet more marginalisation of their business models, or will it simply mean that more business shifts to midshore jurisdictions?
- And what about those mid-shore jurisdictions such as Switzerland, Singapore and Hong Kong? Are these jurisdictions likely to update their tax regimes, noting for example that Hong Kong has already been 'grey listed' by the European Union for its territorial based taxation.?
- Should large-scale UHNW family vehicles be considering all these issues sooner rather than later, or is it a case of 'wait and see'?

Mission – to run the microscope over the current proposals and imagine the implications for the world of wealth management

PraxisIFM was represented by Joanna Caen, who since mid-2020 has been Managing Director of PraxisIFM (Hong Kong) Ltd. She also invited a number of her PraxisIFM colleagues from different jurisdictions around the world to join in the conversation alongside invited wealth management experts in Asia. She opened the discussion, explaining that the concept was to discuss the November 2021 agreement on worldwide taxation at 15% minimum on groups with turnover of EUR750 million or more. "This may have implications, for example, on some family office groups and large families who may have turnover of over EUR750 million and above in places with an effective tax rate below 15%, an example of which could be Hong Kong, where only revenue generated in the SAR counts towards the profits tax, meaning that anything made elsewhere won't be included," she commented. "Moreover, we can imagine that the OECD will not stop at EUR750 million but will later bring the threshold lower and lower. And with that, there are going to be more implications for the traditional onshore jurisdictions."

And with that Joanna invited some experts in 'virtual' attendance to comment on how this might play out for onshore jurisdictions, for example the US, the UK and others.

Part of the mission of the OECD is to reduce what it sees as unhealthy competition based on low or no tax, but not so many groups will be caught up in the net

A key element of the OECD drive, said one expert, was to reduce tax competition, to prevent what they describe as the race to the bottom in terms of tax rates, hence the minimum 15% rate. "I don't think this is aimed specifically at HNW clients, I think it's really a more of a traditional type of multinational corporation, but at the same time, it's clearly going to bring in some family groupings that have a consolidated entity with more than EUR750 million in revenues. The companies, the groups involved will know who they are, because they've been doing country by country reporting for the last couple of years. And in fact, the EUR750 million threshold of revenue means very, very few groups are going to be caught, there is an estimate of only about 8000 groups worldwide, and in Hong Kong perhaps between 200 to 250 groups, and mostly listed, but of course, some private groups."

The EUR750 million threshold can be lowered by any of the jurisdictions, even now

The OECD might later on lower the EUR750 million threshold, but any countries can do so themselves at any time, so for example India has stated they will apply a minimum 15% tax rate to all groups operating in India. An expert also observed that he was most concerned about what he called the 'creep' as the threshold moves down and there will then be more of an impact on

the mature and the offshore financial sectors, bringing into play concerns such as how to segregate a PIC from typical corporate ownership. Another guest reported that Guernsey will see some five groups caught up initially, and that the implications for offshore jurisdictions are far from appealing, especially if the creep to the lower thresholds materialises, as many expect it will.

As usual in a world of increasing regulation, there will be increased pressure on compliance, reporting and documentation. Of course!

A lawyer who was present highlighted that yet again there will be more paperwork and justification required, on either side. And he indicated that with so much what he termed 'tinkering around the edges' going on in the US and elsewhere designed to hit individuals who are receiving corporate income, there will be wider impact from these changes than confined directly to the companies breaching the initial EUR750 million threshold.

China appears as if it might also ride part of the wave and get in on the tax mop-up operation, but in its own way

A guest remarked how the PRC, like the US, has always had a worldwide tax system, but that until now it has not really enforced the protocol. "We do indeed see this trend of tightening up of the worldwide taxation, the enforcement of the worldwide taxation regime coming out of the PRC," said one guest. "And that's why there's a surge of entrepreneurs looking to structure their wealth at the moment."

Countries with higher corporate tax rates are of course less directly affected

A guest said he would echo some comments about how these worldwide taxation regimes are reaching out to catch more PICs in terms of the investment income. "Not Canada where I specialise," he stated, "as a PIC in Canada with the shareholder in Canada has a corporate tax rate of over 50%, the highest tax rate is paid upfront, and later, when you declare a dividend to the shareholder you may get a refund. This means for a HNW family or individual in Canada, who's a Canadian tax resident, you're actually worse off having a PIC and earning your investment income in a PIC, and there are other structuring options."

The jurisdiction in which control is exercised determines the tax rate in many countries

A guest remarked how in the UK, control of the entity by anyone resident in the UK determines the tax rate, not the jurisdiction of the entity itself. However, that did not mean that offshore PICs would no longer be used. "I have a client at the moment for which we are setting up a family investment company in Jersey, and the client and all the shareholders in the company are going to be UK resident, but they're not all domiciled in the UK. The offshore company is therefore valid for future inheritance tax purposes, as when the clients later leave the UK, their estates won't be subject to IHT."

The possible impact on and implications for midshore jurisdictions such as Hong Kong, Singapore and Switzerland

Another expert said she did not expect much impact on Hong Kong

where the tax rate is 16.5% although the effective tax rate is often lower. "Most people we find use Hong Kong as an operational base for business, so mostly these companies are paying actual taxes on their business. They then put the holding company somewhere else, like BVI."

Another view came from a corporate lawyer who commented that the Hong Kong government wants to keep it as a mid or lower tax jurisdiction. "They want to try to comply with OECD, but they're also going to try to make it optimal for companies to locate in Hong Kong. For now, they will wait for the proposed rules to come out and take a look."

Another guest said Switzerland will certainly also be affected by this initiative from the OECD. "We recently had a corporate tax reform, where we lowered the corporate income tax rate in general, so we currently have 20 cantons out of 26 with a corporate income tax rate below 15%."

"There are numerous small and medium enterprises in Switzerland, who are almost like the German Mittelstand, industry and sector leaders in their fields, but just not household names and many within cantons that have rates of tax below this 15% level," another guest commented. "Switzerland as a country, and indeed the cantons within Switzerland, want to guard their jurisdiction and their ability to make decisions for themselves."

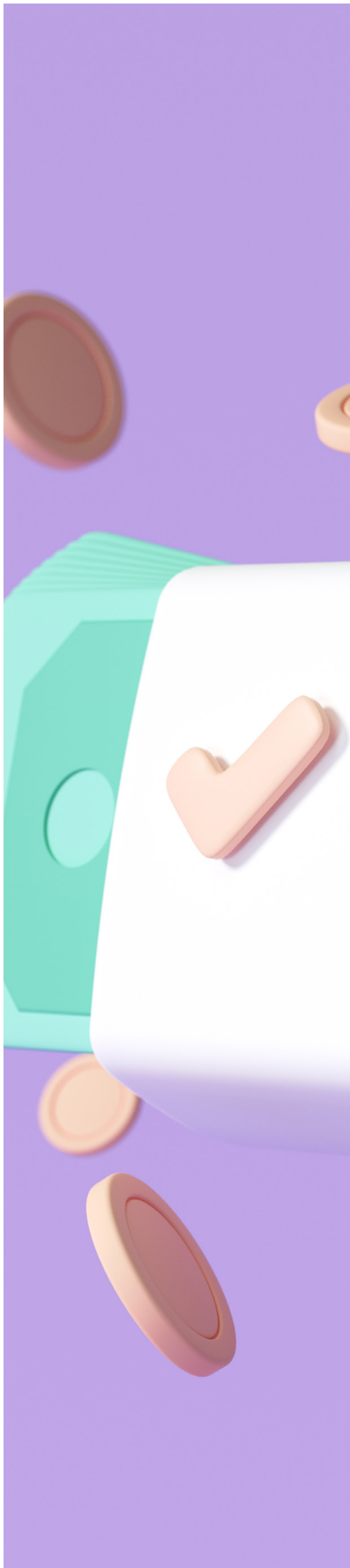
A fellow panellist agreed, noting that Switzerland is certainly not increasing its corporate tax rates. "I don't think that we will increase the tax rates only because of the global OECD initiative."

And what about the impact on the offshore centres, could this be another negative for them, or part of the road to redemption?

A speaker highlighted how the IMF had, for example, only recently informed the Bahamas they need to introduce a 15% corporate tax rate. Did this mean that PICs and holding companies related to private client structures would likely become less useful in offshore centres?

A representative from Jersey indicated that thus far the information they had received on these initiatives indicated Jersey would not be greatly affected. "There are not many holding companies in Jersey of the size that will come under the current proposals," she commented. "Moreover, my personal view is that when it comes to tax, the devil is always in the detail. So, it's very difficult, I think, for us to anticipate sort of what companies, what structures might be caught."

She noted how Jersey has always had a great reputation when it comes to working with the OECD, it has been one of the first adopters, for example in the drive to disclosing beneficial ownership details and in other areas. "But the big question that's difficult for us to assess is whether or not the OECD is going to look through all that and say, notwithstanding all the great regulatory and compliance regimes that you've adopted in order to combat money laundering and so forth, we're still going to require you to adopt a 15% tax rate. Especially as in relation to our domestic system, we actually have different tiers, different tax rates for different types of companies, meaning it will be difficult to dovetail the 15% rate with the domestic system. Accordingly, I can't



really see how they can just sort of impose a blanket rule to say, Jersey or the other jurisdictions, you're going to have to just impose a 15% rate on all companies".

Another view came from an expert on Guernsey, who agreed that like with Jersey there would be only modest impact. "Both jurisdictions are adopting a wait and see approach," he reported. "We are especially interested to see how exactly the US is planning to deal with this one, as I cannot imagine that they're going to throw some of their low tax states under the bus for this. I agree that the devil is very much going to be in the detail."

Turning to the Caribbean markets, a guest commented that this is another reason for people putting forward the theory that offshore is dead, or at least dying. "Our analysis really is that the targets are multinationals that are operating in other jurisdictions, with questions over their core business and substance. On the private wealth side, there are exemptions related to investment funds, pension funds and so forth, which makes an awful lot of sense, and my understanding is that there could be wider reaching exemptions for many of the typical areas of business that we cover in offshore centres anyway."

Another expert observed that the offshore centres also need to be fighting back against the widespread negative media and misreporting. "The offshore centres need to be getting the truth out, given the degree of transparency with which the offshore jurisdictions now operate." He indicated there is a lot of politics involved right now, and the risk is the offshore centres end up being sliced further and further down.

Actually, offshore centres are not supposed to be tax havens, they are pooling centres and can still serve valid and compliant purposes

A lawyer noted that the offshore centres, or tax havens as they've been called, have been the targets of the regulators, the governments and the media for years. But he said that if offshore centres such as the BVI or Caymans imposed any form of taxation, or higher taxes, it would basically spell the end. Why? Because the offshore centres in many cases represent what he called the 'oil of cooperation' between multiple jurisdictions, each of which wants to have and indeed does have their own taxing rights. "You have your fund investors pooling in Cayman, and they pay tax, their investments pay tax, and the investors and holders pay tax when they get some receipts in their jurisdictions, but there's no additional tax layer in the pooling and operational side, for example in the Caymans," he explained. "And that is beneficial for the pension and other funds, and people the world over therefore benefit from that."

He also observed that the BVI situation is somewhat different, as there is not a lot of operational activity going on there, unlike with the Caymans. "There are however valid reasons why people use BVIs" he explained. "For example, in Hong Kong, the register is open whereas there are tens of thousands of BVIs linked to Hong Kong, with those BVI registers not open; this allows for some valuable privacy and other advantages. Indeed, there are numerous BVI companies used related to listed groups where the turnover would be more than EUR750 million. The big property companies have hundreds of BVI companies, and

it is not necessarily or perhaps at all related to tax, as there are other advantages. So, it is to a large extent a negative perception issue."

Are capital gains outside this remit, in other words can regular gains be considered to be outside actual income? It depends on the accounting treatment and if so, then those gains might likely fall outside these new initiatives

A guest observed that it might be worth creating as much capital gain as possible. "In Canada," he explained, "the capital gain income or capital gain is only taxed half. So, basically, only half of the gain is added to the income. So, whether you are earning this at the corporate level, or at a personal level, you do have an advantage."

"I think the capital gains point is an excellent observation," another expert commented. "This proposal has so many complexities and holes in it, even if everybody goes to a 15% rate, if Singapore doesn't tax capital gains, and the US does, then those 15% rates are apples and oranges, you cannot level the field."

Family offices and other family wealth structuring vehicles can and realistically should think about these issues well in advance and plan accordingly

Looking at these issues from a country perspective, a guest highlighted the value in planning around these developments, or at least thinking about potential strategic changes. "The real quick and obvious area is to look at the consolidation rules, which is an accounting concept," he said. "I am not an accountant, but typically, what happens is you would have a very wealthy family, they would have a discretionary trust, they have the PIC underneath, and then you'd have all of the investments and entities under the PIC. So, it's the PIC that's the consolidated entity. A move could, for example, be to split into perhaps two separate PICs that are not part of the same consolidated group, or go further, put it under two separate discretionary trusts because then you would not consolidate. In this way, you might have had an entity that was over the EUR750 million threshold but divided up falling outside the rules. And think about capital gains and where those might be taxed. In short, consolidation planning is I think the obvious thing to think about."

Midshore and offshore will likely remain sceptical and resist whereas onshore and developed markets will keep pushing for major change

An expert reiterated that the devil is in the details and what OECD will require and said he thinks that each government, Hong Kong in particular, will take a look at this from the viewpoint of how they will benefit the local population. The major countries, for example the US, he said will clearly push for this as a means of making things more equal apparently. And the offshore jurisdictions and the mid-shore jurisdictions, they're going to resist, they will say this is core to our business and model and they're going to fight against it. "All in all," he concluded, "who knows how this is going to turn out in two to 10 years from now?"

The final word – much of the actual application and impact of the new rules will be determined by the detail of accounting rules and some jurisdictions will benefit by default

The final word went to a guest who said that the imposition of a corporate tax across the board means you also need to look at rules for deductions and accounting. "For example, you are in Dubai, and the OECD says you must impose 15% on this or that company, but the shareholders simply then pay it all to themselves as a salary, at zero percentage rate tax," he said. "And unless they say you can't get a deduction for your salary, then you haven't actually collected 15% of tax, you just shifted it from corporate profit to salary. Or people pay arbitrage with dividends versus salaries, and then if you impose a 15% minimum on salaries across the globe, then you actually escalate the whole tax system far beyond corporate tax." ■

For further insights on PraxisIFM and on their operations in Asia, please see this August 2020 article on Joanna Caen:

https://hubbis.com/article/praxisifm-hong-kong-s-new-md-joanna-caen-on-growth-commitment-and-the-drive-to-transparency

And please see these subsequent updates:

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