The Sovereign Group's Chairman Howard Bilton on The Virtues of Planning Ahead

Howard Bilton not only presides over The Sovereign Group as Chairman and Founder but also the grapes of his vineyard in the Alentejo in Portugal, which produces wines under his label 'Howard's Folly'. But as he told Hubbis this time last year, wealthy private clients should be careful not to lean towards the other 'folly' of risking their own estates by not properly organising their affairs today and failing to look ahead and planning for business and estate succession as well. We met with him again just recently and heard that he had been encouraged by how, since the pandemic hit, wealthy clients have indeed more diligently grasped the nettle of more robust wealth, business and estate planning. He explained how many such clients have knuckled down to the considerable challenges of devising the right legal, financial and even residency protocols to ensure that transition of what is often very significant wealth and substantial businesses are not impeded by poor planning, which could lead to family disputes and, of course, to very avoidable taxes. Consequently, he advises clients to think ahead, to look forward to further global regulatory and taxation changes, some of which, if they materialise, will have major ramifications for HNW and UHNW individuals and their families.

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In Brief

If changing jurisdiction, residence or citizenship, private clients must make a rigorous assessment of the tax implications rather than simply be lured by a more pleasant lifestyle or environment. Getting the tax status right for the HNW and UHNW clients and their families is vital, and considerable analysis should be undertaken, and professional advice sought.

Bilton warned that the days of the tax nomad wandering the world and avoiding some or possibly all taxes are long gone, and everyone must be fully aware of their global financial and physical footprints and plan accordingly. High tax countries are increasingly legislating to prevent most tax planning opportunities so increasingly tax savings will rely on personal migration to one of the many countries who are vying to attract wealthy individuals with enticing tax breaks and special tax regimes for new residents.

Bilton highlights some excellent countries in Europe for residence, such as Greece, Italy, and Portugal, which offer appealing schemes for arrivals investing in the country and for retirees. Surprisingly, mainly for foreign citizens, the UK's non-domicile regime offers wealthy clients considerable tax advantages. And of course, there are low tax countries in the Far East and elsewhere, or even no-tax jurisdictions such as Monaco and others.

However, whichever option these clients take up, should they wish to move, they need to be careful. For example, for British domiciled persons, even if they were to move to a country with no estate duties, it would take many years and a demonstrably irreversible leap to extract themselves from their UK domicile and therefore from UK inheritance tax.

It might be a thorny issue politically and socially for governments to tax locals so heavily as they seek greater revenues and at the same time offer incentives for wealthy foreign arrivals, but the governments around the globe appear to think this right in their pursuit of the global tax dollar, euro, pound or any other currency.

The pandemic has no doubt enhanced the focus of the world's wealthy on ideas such as moving jurisdiction and at the same time driven them to address estate, business and succession planning more robustly. Those who do not do so risk getting burnt by the ever-more tireless and attentive tax authorities and regulators around the world.

Economic substance is another thorny issue, as the OECD seeks to advance its hopes for a harmonised 21% tax rates across its member countries. Why should some of the global brand Big Techs and others be able to transfer price revenues out of countries where they are so evidently making so much money? Well, that is because the existing rules often promulgated by the OECD themselves allow them to do so. Now the OECD want to change the rules primarily to further tax US tech giants who they believe should be sharing the fruits of their success with countries in which or with whom they trade. Despite their own rules suggesting they don't have to. Will the OECD win through? Not yet, as particularly the US seems to prefer global competition for corporate investment and therefore revenues. The current situation favours global brands, many of which are the gigantic US corporations such as Amazon, Apple, Google and others so it is hard to imagine why the US would agree to changes in the rules which will penalise these companies and share their success with other countries.

If the OECD does win its argument, the implications for private clients and their worldwide strictures and for the International Financial Centres, for example the Caymans, Jersey and many others would be dramatic, as the OECD's 21% minimum corporate tax rate would be imposed by default even on non-OECD jurisdictions. In short, the demise of the rationale for IFCs in any current form could be ahead.

Change is inevitable, so private clients of all types and in all locations need to be fully informed of these issues and organise their affairs and their planning robustly adroitly.

In a fairly recent advisory he sent to his clients, Bilton and his team tackle the issues of changing residency or citizenship and the bigger picture of proper estate and legacy planning. The paper advised wealthy private investors and families to consider long and hard before they change residence or even citizenship. The note recognises that in the absence of office working, there is greater flexibility, theoretically at least, in terms of the jurisdiction in which to live and more opportunity to consider a different country, lifestyle, culture or climate.

"The days of a tax nomad that cannot be pinned down to any regime are effectively done and dusted, as exiting one country's tax system increasingly requires entering the tax system of another"

Those who have taken the chance to work in a new country may find they have already become tax resident there and are subject to local tax rules, the note cautioned. They may also remain tax resident in their 'home' country as well, as it is perfectly possible to be tax resident in two or more countries at the same time and to be subject to tax on the same income in more than one place at the same time.

If there is a double tax treaty in force between the two countries, this would generally determine which of the two places gets the taxing right but sometimes , Bilton wrote, instead of this tie -breaker there is a credit system where credit is given for tax paid in one place against the tax due on the same income in another.

Getting it right

"Getting the tax residence and status right is essential as a first step," he says. "Tax treaties are specifically designed to prevent double taxation but can result in the highest rate of tax applicable in both countries being paid."

The advisory explained that most tax treaties contain a tie-breaker clause, which gives the sole taxing to the country where the taxpayer has a permanent home available, or if here is a home in each place, then it will be decided by the taxpayer's personal/economic ties, or if that is roughly even, then the country where the individual has a habitual abode or perhaps by nationality. If all of those criteria are roughly even, then the two jurisdictions must settle the matter by mutual agreement.

Plan carefully

The paper then highlights the many ways in which individuals can remove themselves from tax nets in one country, but only, Bilton warns, if they take up clear tax residency in another jurisdiction. "The days of a tax nomad that cannot be pinned down to any regime are effectively done and dusted," he says, "as exiting one country's tax system increasingly requires entering the tax system of another"

The paper also highlights some interesting countries to consider, such as Greece, where permanent residency is available to anybody who invests EUR250,000 in real estate and offers a number of tax incentives available to new residents, such as pensioners taxed at a rate of only 7%, and entrepreneurs taxed on only 50% of their income.

Some great options

Italy offers new residents a flat rate tax charge of EUR100,000, irrespective of income, for the first 15 years, which is of considerable appeal to wealthy investors and families, while those earning an income can have up to 70% of their income exempted from tax for five years, or even 90% if they reside in a nominated deprived region of Italy.

Portugal offers the Non-Habitual Resident (NHR) regime, which, with careful structuring provides a ten-year tax-free holiday to new residents (apart from pension income, which is now taxed at 10%). The Golden Visa scheme in Portugal also offers permanent residency to new non-EU residents in return for an investment of EUR350,000 to EUR500,000 in an approved investment, which includes real estate.

The UK – still great for non-doms

The paper highlights how the UK will generally treat any new resident from a foreign country as non-domiciled in the UK and therefore only subject to tax on income arising in the UK or foreign income that is remitted to the UK.

"In practice," Bilton comments, "it is actually relatively simple for high-net-worth individuals to structure their affairs so that they pay little or no tax in the UK and also remain outside the scope of the UK inheritance tax (IHT) regime, which is 40% of the capital value of a worldwide estate. This 'non-dom' status can, with a little

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careful planning, last indefinitely and certainly for 15 years."

Many countries in the Far East – notably, for example, Hong Kong, Singapore and Thailand – only tax territorially. He explains that it is therefore relatively simple for those who are not working in the country to avoid all tax. Finally, of course, there are a large number of countries or territories that do not charge any sort of tax. These include Dubai, Monaco and many of the Caribbean countries.

Don't get burnt!

Nevertheless, whatever jurisdiction is chosen, Bilton cautions that care should be taken to ensure that it is not a case of 'out of the frying pan and into the fire'.

"It could be the case that having achieved substantial savings on income and capital gains tax, new arrivals find themselves exposed to additional wealth or capital taxes and/or inheritance tax/estate duties," he elucidates. "Countries such as Spain and France, for instance, charge an annual tax that is based on the capital value of a taxpayer's worldwide estate. The rate of such taxes may be low but can add considerably to the overall tax burden."

He adds that UK nationals, on the other hand, generally remain domiciled in the UK and therefore subject to UK IHT at 40% of their worldwide estate even after having lived abroad for many years.

The concept of domicile – a thorny issue

"Disconnecting from UK domicile is a rigorous process," Bilton explains. Moving to a new country permanently presents clients an opportunity to shed their UK domicile and consequent liability to UK IHT, but it takes time to establish that new domicile. A UK national moving to Portugal could (or should) be able to establish a Portuguese domicile of choice after residing there for, say, five to seven years provided that they intend to remain in Portugal indefinitely. This would be massively advantageous as Portugal does not levy either wealth taxes or estate duties. Accordingly, this is out of the frying pan and out of the fire, which is a great outcome."

Is it fair? Governments think so...

He reports that there is somewhat of a global competition going on to attract wealthy individuals and families by lowering their tax liabilities. This is, however, potentially socially divisive as governments squeeze the locals that they can keep control of with ever more tax and regulation while taking a liberalised view of tax breaks for the wealthy arrivals. "It is understandable that people might complain," he observes, "but the government theory is of course that these wealthy people bring money and economic activity of all types."

He concludes this portion of the discussion by remarking that, for the moment, there is choice and therefore considerable competition to attract wealthy individuals to the shores of many countries, and that the pandemic has provided yet more impetus for private clients to consider such moves, forsaking what some might consider the misery of overcrowded cities in colder climes in exchange for the joys, for example, of the warm climates and pleasant, less cluttered lifestyles of the southern European countries.

Substantial revenues and issues of substance

In another paper his firm released, Bilton and team address economic substance from a corporate perspective, noting that there is a worldwide drive to try to capture as much tax as possible in those jurisdictions where the companies generate their sales, rather than losing this revenue stream to other jurisdictions to which these companies 'offshore' their profits through a host of transfer pricing, management, intellectual property and other management fee charges, which although they might be legal, are increasingly scorned by tax hungry authorities.

Amazon, for example, pays little or no tax in the UK, despite selling vast amounts of goods in the UK. Amazon, Bilton reports, relies upon the internationally-agreed principle that when goods are sold over the Internet, the point of sale is the place where the computer server hub is located. In the case of Amazon, that happens to be in Luxembourg.

Playing between the lines

He reports that both the UK/Luxembourg and the UK/USA tax treaty contain the same standard OECD 'Permanent Establishment' (PE) article; this states that a company can maintain stocks of goods for storage, display or delivery in the UK, without creating a PE in the UK. "As it stands, if there is no PE, there is no taxation," Bilton reports. "Article 5 of the treaty allows the Amazon warehouses in the UK to not be classified as PEs; hence they do not create a taxable base."

He elaborates on this, remarking that the UK encouraged Amazon and others to invest in the country under these rules, and therefore it seems very unfair to change the rules and impose hefty taxes now they have sued those rules to be successful. "For example, Starbucks doesn't pay much tax in the UK as it charges a royalty to its own UK outlets for the use of the Starbucks name, its know-how, its purchasing economies and its systems," Bilton reports. "But why shouldn't it? Starbucks central has spent many millions making that IP valuable so it seems only right that its franchisees pay something for the use of that it"

Every country has its own agenda

"Ultimately, if the UK imposes more tax on Amazon, it is the US that will lose out because somewhere down the line the US will be obliged to offset any tax paid in the UK against Amazon's US tax liability," he explains. "That is why the US is understandably somewhat resistant to imposing tax on its companies that would be both contrary to the tax agreements it has signed and contrary to established international practices."

He also notes that the US could, if it wished, broaden the scope of its Controlled Foreign Corporation (CFC) legislation and tax the undistributed profits that are currently being rolled up low tax jurisdictions abroad. That is a matter for US. If they do impose such taxes, it won't increase the tax take of the UK or elsewhere where Amazon has customers.

"However," he elaborates, "one can surmise that the US has decided that it wishes to allow its companies to invest gross of tax rather than net. After all these offshore arrangements only defer tax. Eventually those dividends will come back to the US and will then be taxed. The US is giving up tax today to receive more tax tomorrow, while Amazon is getting a cash flow advantage. It could perhaps even be argued that this is some form of artificial 'state aid' that gives US companies a competitive advantage."

21% corporate tax for all? Not yet...

He observes that the OECD had fairly recently announced a project that seeks to get all its members and territories under their control to impose a minimum rate of tax. In this scenario, the UK, for example, would impose a minimum rate of tax on all the International Financial Centres (IFCs) that it can influence. This includes most of the Caribbean jurisdictions, the Channel Islands, the Isle of Man and others.

Many of the other IFCs are under the control of the Netherlands, so would be brought into line by the Dutch government. And then all OECD members would presumably impose severe sanctions on any independent jurisdictions

such as Panama, Bahamas, Hong Kong (China), Singapore and other lower tax jurisdictions that failed to comply.

The suggested tax rate of 21% is actually higher than the corporate tax rates of some OECD member countries, such as Ireland, and, indeed, the UK, where corporate tax is currently now 19% at the lower level but will rise in coming years.

"And the US presumably recognises that one of the major problems with a uniform tax rate is that the 'headline rate' of tax is only one element in a tax system," he adds.

Moreover, the actual outcome might, in reality, be negative for some economies, as the big companies currently under attack might stop investing further in various countries, Bilton cautions.

"It remains unclear as to what will evolve, but this needs to be watched carefully. The there is some considerable evidence that high rates of taxation, in the end, cost a country money rather than make it money. Hong Kong is a good example of this; lower tax rates ultimately result in increased revenue, not less, because a lot more people and companies want to do business, either with or in your jurisdiction."

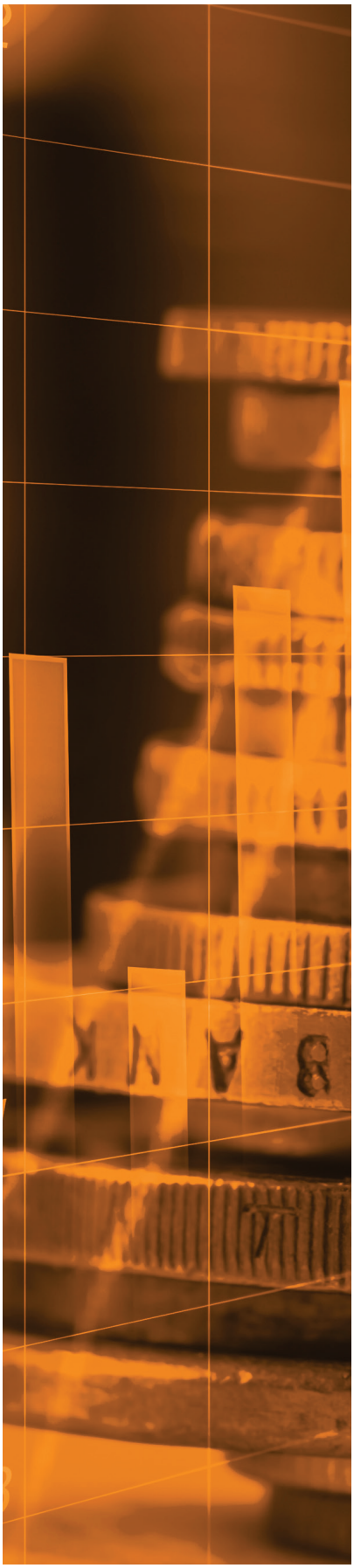
The US prefers competition to a single rate

However, he notes how the US government back in 1989 after the OECD first tried this approach following its "Report on Harmful Tax Competition" swiftly indicated that it would not support an attempt to force countries to introduce any particular level of taxation. The stated US position then was that tax competition was a good thing because it creates efficiencies and obliges countries, like companies, to compete for corporate revenues. Instead of trying to harmonise tax rates, the US suggested that the OECD should focus on transparency so that high tax countries could obtain the information they needed to tax their companies and citizens more effectively and according to their rules.

The Sovereign paper explains that there are other approaches being looked at to secure a fairer tax dollar related more directly to economic activity in any country, but as yet there is really no viable progress.

Watch this space...

"The impetus is there to revise the tax rules to reflect a digital age," Bilton summarises, "but as yet, it is tough to see what is in it for the US, whose global corporations are benefiting most from the current scenario. I think the US, if they go down this route to corporate tax harmonisation across the OECD, will just extend their own legislation and try and get more tax in the US. It is hard to imagine what would move them to volunteer to share tax it could take for itself with other countries, but we will see."



Bilton says if things change again and the OECD proposals do actually bear fruit, offshore tax planning for wealthy clients will be turned upside down. "It remains unclear as to what will evolve," he says, "but this needs to be watched carefully. The there is some considerable evidence that high rates of taxation, in the end, cost a country money rather than make it money. Hong Kong is a good example of this; lower tax rates ultimately result in increased revenue, not less, because a lot more people and companies want to do business, either with or in your jurisdiction."

Private clients need to be aware

In a world where corporations and their activities, and indeed their top people, are so mobile and where communication and data have no borders, companies and investment can shift quite seamlessly around the world. And remember, he says, that if the OECD members do take this tax levelling route, there are plenty of non-OECD countries that would be very well placed to attract a lot of business. "This, in turn, means that for the plan to work, the OECD would have to agree to penalise people trading with any countries that do not themselves follow. It would be an effective trade war using tax." he observes.

He extrapolates further to consider the implications for private clients who book their private banking arrangements offshore because of the low tax rates. They might comply with the relevant rules in their home jurisdiction but will likely be getting some tax advantage out of their money being in some of the offshore centres.

And the IFCs must be worried

"But if IFCs such as Guernsey, Jersey and the Isle of Man and others are forced to impose minimum rates of tax on all structures, corporations or whatever in their jurisdiction," Bilton explains, "there will really be little or no point in using them. So, they could well be out of business, which is not great for them, and everybody might have to rethink their tax planning. But let's see if it goes anywhere, or if the US in particular is just paying lip service to such discussions."

Change is inevitable

He concludes the discussion by reminding us that those wealthy private clients and their families who are considering offshore structures, organising their estate planning and business succession plans, and even potentially considering a change of residence or citizenship, need to think long and hard about what they wish to achieve, and the 'hows' as well as the 'whys'.

"Change," he says on closing the conversation, "appears inevitable, especially as governments around the world face up to the realities of their national deficits, so that means being well positioned ahead of the 'game' will stand HNWIs and UHNWIs in good stead for the future." ■