The Rising Tide of Complexity and Accountability in the World of Wealth

The Hubbis Compliance in Asian Wealth Management Forum 2020 in Singapore launched with a highly topical panel discussion focusing on the key compliance challenges for the year ahead. The experts on the panel highlighted the intensifying drive from regulators for higher standards of conduct, greater individual and corporate accountability, enhanced monitoring, and how the banks and other wealth management firms can react with more training, more defined standards and digitisation.

These were the topics discussed:

- *Economic Substance vs. Opaque Offshore Structures - What is the Practical Difference?*
- *CRS Pre-Audit Preparation: what are the top 5 things that all Singapore Financial?*
- *Institutions need to do before their first formal IRAS CRS audit assessment?*
- *CRS anti avoidance and Mandatory Disclosure - has Singapore in effect introduced the CRS?*
- *Mandatory Disclosure regime?*
- *Tax Havens vs International Financial Centre. Cayman vs Singapore - what are the new developments you must consider?*
- *Tax optimisation - what does that really mean? What strategies can you adopt?*
- *How to best obtain cooperation from clients to meet tax compliance standards?*
- *What more can be done to educate clients about the potential impact on them of tax transparency?*
- *Singapore Variable Capital Companies - opportunities and challenges?*
- *Individual Accountability & Conduct in relation to your role and advice - what's changing?*

PANEL SPEAKERS

- **Christina McNamara,** Associate Director, Operational Risk &Regulatory Compliance, IHS Markit
- **John Shoemaker,** Registered Foreign Lawyer, Butler Snow
- **Zac Lucas,** Founder, Head of Legal, Centenal
- **Tan Woon Hum,** Partner, Head of Trust, Asset & Wealth Management Practice, Shook Lin & Bok
- **Laurence Lancaster,** Barrister-at-law, Group Head of Tax, Sovereign Group
- **Shaun Zheng,** Tax Associate Director, Nexia TS

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THE KEY OBSERVATIONS

To avoid or to evade? The lines of separation are increasingly muddied...

The old distinction between tax evasion - illegal - and tax avoidance - legal - remains a relevant principle, but the two terms have moved closer together in recent years, with aggressive tax avoidance now effectively treated as tax evasion.

There is a global shift to supervision based on substance over form

There is a worldwide shift to substance over form, transparency over opaqueness, full disclosure and exchange of information over poor transparency. Accordingly, most wise investors will want to steer clear of tax avoidance schemes, and so also advisers, who will increasingly be caught up in the nets.

One judge's meat is another judge's poison

As interpretations on tax matters and transgressions can often ultimately be decided in the courts in most civil law jurisdictions, Asia's wealthy and their advisers need to appreciate that one judge might consider a tax mitigation scheme legitimate while another might consider it tax avoidance. There is a genuine conceptual distinction, but interpretations differ, so beware.

CRS audits are around the corner, be prepared

The rollout of CRS and soon the CRS audits continues apace. Private banks and other wealth management firms must get their acts together. Most global banks have already conducted internal CRS reviews on implementation and remediation, while many of the smaller and local institutions are now reportedly going obtaining external FATCA/CRS reviews. In short, be wary of procrastinating.

MDR is part of the regulators' medicine bag

Mandatory Disclosure Rules (MDRs) have not yet been adopted in Singapore, and it will likely be a while before they do so, although pressure from the OECD will ensure Singapore later participates. But anyone in the wealth management industry must be aware that the regulators worldwide see MDR as a necessary medicine that will help cure impropriety, so the stipulations will filter out into every market before long.

Economic Substance rules must be considered seriously

Economic Substance rules are designed to put an end to an opaque structure designed to deceive and obfuscate. Transparent structures and full reporting must, therefore, become the new norms.

You must know (and tell) if you are an UBO

Just as with opaque structures often secreted in exotic jurisdictions, ultimate beneficial ownership (UBO) provisions are being tightened up, and those transgressing these guidelines and not reporting properly will be considered as owners of a potentially abusive structure, and therefore non-compliant for tax and reporting purposes.

Clients must be more conservative in their approach

There are many risks associated with structures that are too aggressive, including even whistle-blowers from within, or disgruntled ex-employees. Data is transmissible at the click of a mouse, so err on the side of conservatism and compliance.

Education is essential for all parties involved

The older mindset of opaque must be replaced with the new mindset of transparency and compliance. And for Asia's wealthy investors, they should seek out jurisdictions that enhance their reputation and feeling of security. In a world of greater complexity, simplicity is the key.

CHRISTINA MCNAMARA
IHS Markit

TO SET THE SCENE, A PANELLIST OFFERED HIS INSIGHTS INTO WHAT TAX OPTIMISATION REALLY MEANS. The old distinction between tax evasion - illegal - and tax avoidance - legal - remains a relevant principle. However, the two terms have moved closer together in recent years with aggressive tax avoidance now effectively treated as tax evasion.

"With the shift to substance over form, transparency over opaqueness, full disclosure and exchange of information, most taxpayers will want to steer clear of tax avoidance schemes," he observed. "As will advisers who may now be exposed to severe penalties if they have been involved in tax avoidance which fails in the courts, as indeed most avoidance schemes now do.

The Emperor's New Clothes?

He noted that there are new terms such as tax optimisation, tax planning and tax efficiency. "Arguably these terms are the Emperor's New clothes," he said, "because in substance there is no difference between tax avoidance and tax planning as both achieve the same result, i.e. the taxpayer pays less (or possibly no) tax. However, under common law, the courts have attempted to distinguish between tax 'mitigation' on the one hand and avoidance on the other. Tax mitigation, being where a taxpayer genuinely reduces their income or incurs expenditure, from which the tax advantage is obtained. Tax avoidance involves a taxpayer reducing his liability to tax without

JOHN SHOEMAKER
Butler Snow

ZAC LUCAS
Centenal

actually incurring the loss or expenditure that entitles him to the reduction, and so does not incur the economic consequences that the legislature intended for the reduction in tax to apply."

He gave the example of mitigation as 'bed and breakfast planning' such as selling shares whilst resident in Singapore before retuning onshore and then buying back the shares. Whereas tax avoidance could for example be dividend stripping, creating a loss by a trader in shares buying shares, stripping out the dividend then selling on the shares for less than acquired.

TAN WOON HUM
Shook Lin & Bok

Code words?

"In short," he surmised, "any form of tax optimisation and tax planning, whichever euphemism is chosen, will want to try to fall within the concept of tax mitigation rather than tax avoidance. There is a genuine conceptual distinction but admittedly, one judge's avoidance might be another judge's mitigation."

IRAS, the tax authorities of Singapore, has clearly indicated the intent to begin their CRS audits, having reached out already to the local banks in Singapore to provide feedback on timing and scope of audits. According to one panel member, IRAS has only seven staff and has no capacity or training to actually execute on-the-ground audits anytime soon, accordingly this expert indicated that the early audits are therefore likely to be desk-top reviews.

It is evidently the intention of the IRAS that FIs have independent reviews in preparation for CRS audits. Most global banks have already conducted internal CRS reviews on implementation and remediation, while most of the smaller and local institutions are now reportedly going out to market to have external FATCA/CRS reviews.

The OECD Working Group has an internal draft of their CRS Compliance Guideline that is expected to be released within the coming months to assist jurisdictions is carrying out CRS audits. "This," said one panellist, "shows OECD's intent for a regulatory environment of auditing across all CRS jurisdictions."

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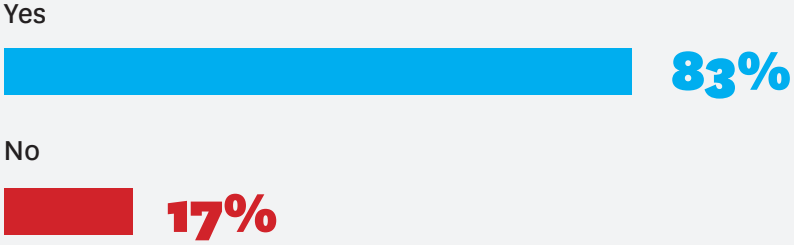
Proving your substance

On Economic Substance a panel member observed that an opaque structure in a technical sense means that the taxpayer is not taxed on fund growth until distributions are made from the structure. A typical example of such a structure would be a

DO CLIENTS STILL GET CONFUSED AROUND WHAT THEIR RESPONSIBILITIES ARE AROUND TAX AND DISCLOSURE?



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life insurance policy and certain types of mutual funds. An opaque structure contrasts with a transparent structure as with the latter a taxpayer is taxed on fund growth as it arises.

The prime example of a transparent structure is a partnership where the income belongs to the partners on which they are taxed as it arises. Many onshore states have rules which deem the income and gains of overseas structures to belong to the Ultimate Beneficial Owner (UBO), so that for example most onshore states have controlled foreign company rules or equivalent, ensuring the UBO is taxed on fund growth as it arises in the structure.

LAURENCE LANCASTER
Sovereign Group

Don't run and hide

However, more recently, after the Panama papers and other denouements, opaque has been used in an emotive sense connoting a structure which has been set up for an illegal or illegitimate purpose such as tax evasion, defrauding creditors or concealing assets ahead of divorce. In all cases, the UBO has something to hide and uses the structure for this end. "It is important to bear in mind that this type of opaque structure may well have substance," he added.

Economic substance is concerned with the substance of the structure itself and has been borne out of the OECD's Base Erosion and Profit Shifting (BEPS) project and the EU's Code of Conduct Group, and has its origins in OECD's report on Harmful Tax Competition dating back to 1998.

Aside from economic substance, the term substance has been used in the structuring world for many years. For example, a basic level of substance will be required to ensure that a company is resident in the same place as it is registered (under the effective management and control test).

And with tax treaty planning where a company is used, it will normally need to be the UBO of the income/gains which will require a basic level of substance in the country of registration/residence. But as far as UBO's of structures are concerned, all structures (with or without substance) are potentially compliant assuming correct filing and payment of tax by the UBO as required in their country of residence. Moreover, a structure with substance may well have been set up for non-tax reasons and it is less likely that such a structure would be used for an untoward purpose, so is less likely to be an abusive structure. but the point should never be assumed).

Abusive structures

An expert offered an example of an abusive structure which has substance. A UK resident and

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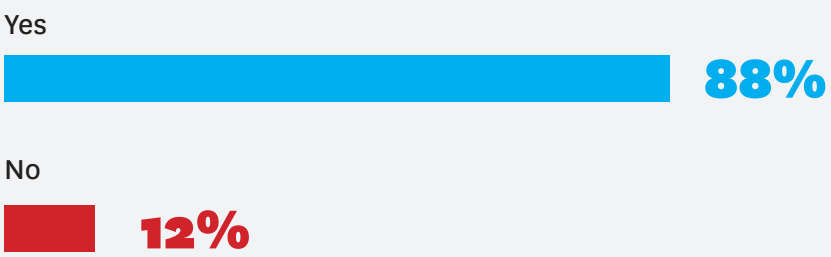

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domiciled individual sets up a trading company in Singapore with local third-party directors, company secretary, local staff and bank account. The company genuinely carries on its trade in Singapore. The company undoubtedly has economic substance. But the UBO fails to report the existence of this company on his UK tax return and report the income rolled up in the company, so the structure is opaque, i.e. abusive, and non-compliant for UK tax purposes despite the company having substance.

And he offered an example of a compliant structure which has no substance. The same person sets up a shelf company in Belize, which holds passive investments. The company directors, nominee shareholders and bank account are based in the Isle of Man. The company does not have economic substance. However, the UBO reports all income and gains that accrue to the company on his UK tax return and pays tax accordingly. The company is treated as tax transparent in the UBO's country of residence as the income and gains are deemed to belong to him; he accepts and pays tax in the UK on income and gains as they arise in the company.

A panel member said the stability and transparency available in Singapore had been attracting more and more investors and structures to its shores, and the Singapore Variable Capital Company would further enhance its appeals.

An expert observed that investors from more advanced economies, including within Asia are less interested in the Caribbean and other exotic jurisdictions, due to the lack of transparency, some reputational tarnishing and the lack of infrastructure. Those jurisdictions will need to somewhat reinvent

SHAUN ZHENG
Nexia TS

themselves and had already shifted their focus in terms of clientele to other markets, for example investors from Africa and elsewhere. However, he added that the Cayman Islands and funds there will survive, due to the connections to the US and because of the insurance industry.

"I regularly tell clients if you are too aggressive or if you are trying to get to zero tax, your assets and your structures are only as safe as the lowest paid employee that has transparency on what you are doing," said one expert. "Because whistleblower awards and percentages are ridiculous high. Whistleblowing likely will play a role coming up with increased transparency and more employees having access to data and awareness of families, corporations and assets."

Here comes MDR

MDR, said one guest, must be prepared for. "Currently it is only in the EU, but it is retrospective," she said, "so, you will have to

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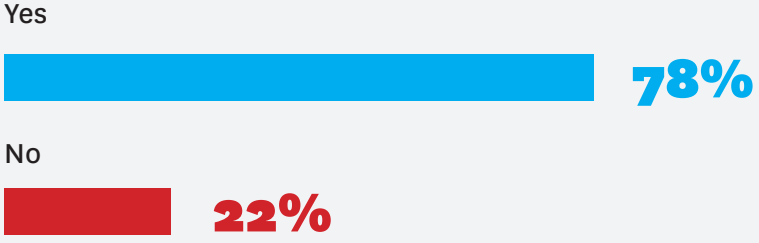

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comment and report out structures as far back as 2014." A fellow panellist concurred, noting that each time hie might now pick up the phone or communicate with his London-based lawyer colleagues, he has then potentially created an MDR DAC6 exposure. "So," he concluded, "in some ways, it has come here to Singapore if you operate across multiple jurisdictions."

"You still do get clients coming through the door, how do I avoid this, but frankly their mindset is stuck in the past where those opaque or rather abusive arrangements were set up by providers in the past. So, educating those clients that we live in a very different world is essential."

Singapore was hailed by the panel as an example of a jurisdiction that is being immensely successful with smart incentives and regulations intent on drawing in family offices representing immense personal or family wealth. "The Singapore tax incentives such as 13X or 13R have actually been around some years but now extended to the single-family office," he remarked, "Singapore looks at the contribution to Singapore, so it is not just money or assets, they want entrepreneurs, they want people to come in to build something, to hire people, preferably Singaporeans, create jobs, build the technology."

The panellists turned to their advice to the delegates and therefore, ultimately to their end clients. "In reviewing arrangements, you need to focus on the concept of tax mitigation rather than tax avoidance, to make sure that whatever is structured is underpinned by specific legislation, rather than actually trying to manipulate rules and loopholes to come up with a plan that results in you paying less tax."

Another expert agreed, noting that there had been a large portion of the private client base that had been used to opaque structures, to shifting assets and earnings offshore in the past several decades.

"We now have the global transparency initiative and an enormous amount of data flying around, not just through CRS," he explained. "Tax authorities eventually will start digesting this information and then you will start to have the beginnings of the tax investigations and the prosecutions. Accordingly, I would encourage any financial institution that has been involved in these areas, these cross-border activities, begin some level of contingency plan as to how you deal with a tax investigation when it arrives. And start thinking about how to deal with the ramifications relating to employees such as RMs and the senior management."

Keep it simple

"My advice," came another voice, "is to keep things simpler, keep the structures simpler. There is no reason to have those structures in opaque jurisdictions. And if people are coming to Singapore, we ask them precisely their objectives and try to ensure that they are compliant, and do not think they can avoid obligations or other commitments." Another panellist concurred, adding that clients do not just need long, technical emails of explanation, they need to have this drummed in by phone and face-to-face time and again."

The final word went to an expert who said the pace of regulation and the demands of compliance and the authorities will only continue to be more incisive and more invasive. "Prepare for what is ahead," they advised, "prepare for the CRS audits, for MDR conduct internal and external reviews, communicate with your clients about the rules and the impact, so they understand clearly what different structures that the authorities may be looking into, and what will be reported where." ■