INDUSTRIE- UND FINANZKONTOR

WEALTH PRESERVATION EXPERTS

NEWS

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DR JEKYLL OR MR HYDE?

The international community of nations has caught a serious case of «gold fever». Under the banner of tax transparency, they are striving to obtain as much information as possible on wealth and personal income. Unfortunately, they neglected to check the practicability and efficiency of their makeshift tools. The automatic exchange of information (AEOI) is a classic example of a bureaucratic masterpiece, the practicability and reasonableness of which has caused more than just the occasional shake of the head.

Tax compliance is one thing; wealth protection and wealth preservation is another thing entirely.

The AEOI obliges the participating states to exchange electronically an array of information on taxpayers' assets and income flows. Although officials have made assurances to the contrary, data protection plays only a trivial role here. Moreover, a refusal to take part in the AEOI is a no-go: any recalcitrant runs the risk of being added to the international hit list of the most un-favoured nations. But why all these costly machinations? The purported problem of tax evasion could be solved much more simply and cost-effectively: for instance by making greater use of existing withholding tax schemes; or by simplifying the tax codes or by seeing to it that state activities, outlays and services offer such a comprehensible, tangible benefit that citizens are willing to pay taxes and other imposts without any ifs, ands or buts.

So what is behind this ravenous foraging for information, a pursuit that has reached an entirely new dimension with the introduction of the AEOI? Perhaps a bit of clarity in this regard can be gained from the words of philosopher Francis Bacon, who in the late 16th century drew the terse conclusion: «Knowledge is power.» If that be true, then the amassing of information is the shortest path to knowledge; ergo, power. And then? Lord Acton later had his own way of putting a finer point on the issue: «Power tends to corrupt, and absolute power corrupts absolutely.» It follows that the greater the amount of knowledge, the more devious the intentions can be. Knowledge engenders a power gap, and dealing honourably with that edge is a fine art in itself. One need only think of the literary classic Dr Jekyll and Mr Hyde – an impressive example of how an originally «well-intended initiative» can have a disastrous outcome. Could it be that the biggest problem lies in the fact that those involved are often not even aware of the ill that looms ahead on the path their initiatives are taking them?

Tax compliance is one thing; wealth protection and wealth preservation is another thing entirely. We have grappled with the many aspects of the AEOI and come to the conclusion that even the automatic exchange of information cannot hinder the latter quest. And just as an aside: the English term «to tax something» can also mean «to overstretch something».

Michael von und zu Liechtenstein
Chairman of the Board

THE SOMEWHAT DIFFERENT INTERVIEW

As of 30 June 2017, reporting will commence in connection with the automatic exchange of information for tax purposes (AEOI). Liechtenstein legal entities will also be subject to this new regime. But what does the AEOI actually involve? Rather than giving you a technical lecture on this highly complex issue, we thought: What would a certain Mr AEOI say about the matter, if in fact *he* could? The result is a fictitious interview which – we hope, at least – addresses the key issues in a way that makes them good reading.

Mr AEOI, you are one of those characters who are getting a lot of attention these days but polarising people in the process. How do you feel about that?
Well, what can I say? I am aware of the fact that some people refer to me as a «bête noire», and that makes me think of course. It is my job to make taxpayers more calculable and more compatible with the system, so to speak. That means I have to lay down the law and people have to obey it. Some of them might find that annoying.

So one could in fact consider you to be the successor of the EU Savings Directive?
Yes. Starting in 2005, the EUSD was given the task of making sure that tax was paid on investors' interest and dividend income. All the EU member states got together and agreed to exchange this data with each other automatically. Their goal was to subject that kind of extraordinary income to taxation in the EU country where the beneficial recipient actually lives. But it quickly became clear that there was a fly in the ointment. For one, certain EU/EEA member states managed to introduce their own withholding tax on interest income, thereby elegantly extricating themselves from the confines of an automatic exchange of information. And secondly, it turned out that the EUSD had neglected to take into account an array of other revenue-generating assets.

And so you have been put in charge. What is your assignment now?
Well, the idea actually came from my colleague in America, FATCA. What I have to do today is make sure that as much information as possible on tax-relevant assets is exchanged automatically between all of my partner states. This way, their authorities can count on having what they like to call a broader tax substrate. But I did not totally follow suit with FATCA – she has her own odd ways. For me, what is important is the *principle of reciprocity*. In other words, the local tax authorities commit to forwarding the relevant information to their associates in the other partner states, but in turn they also have the right to request and receive the same type of information from those authorities. I want to avoid one-way conversations.

How do you aim to ensure that exchange of information functions properly?
I will be taking a three-pronged approach. The first element is a so-called *Model Competent Authority Agreement (CAA)*. It specifies how the automatic exchange of information is to be uniformly handled by the participating tax authorities. And it serves as the substantive framework for bi- or multilateral agreements between the participating states. Liechtenstein, for example, has already concluded a multilateral pact with all EU member nations based on the CAA. Then the second element comes into play: the *Common Reporting Standard (CRS)*. It specifies who needs to supply the tax authorities with what information, as well as how the bank accounts or assets can be identified as relevant. The purpose of the CRS is to make sure that the tax authorities are exchanging standardised datasets and that, in the process, a certain degree of due diligence is performed. The third element consists of a commentary and examples of technological solutions that address the data security dimension.

Back to the EUSD for a minute. What is going to happen to her?
I believe she will simply have to leave. But Brussels will have the final say on the matter, and they are still trying to decide.

My job description says: Obtain the information necessary to form a clear picture of assets and revenues.

Which information are you actually interested in?
My job description says: Obtain the information necessary to form a clear picture of assets and revenues, as they could be of relevance for tax purposes. That is why I am generally interested in things like the names, birth dates, places of birth, addresses and countries of residence of so-called *controlling persons*, meaning the people who have a beneficial interest in the given assets or exert control over trusts, foundations and similar structures; but I am also interested in information on the financial institutions or companies that are doing the reporting. What really interests me, though, are the hard numbers: tax ID numbers, account

numbers, the year-end balances in current accounts and securities accounts, and of course the total amount of income those assets generated in a calendar year.

That is a vast amount of information you are looking for. Couldn't you make do with a bit less?
The reason for this whole exercise is to make it impossible for people to avoid paying taxes by simply shifting their assets to a foreign country. With the information I just described, the tax authorities should be able to fulfil their state-mandated performance obligation. And for them to do that, they need to have sufficient input on the assets and financial status of all those people who are taxable in their jurisdiction and have a beneficial interest in assets held abroad or otherwise effectively control a legal entity domiciled in a foreign country.

But how do you intend to make sure that the exchanged information does not fall into the wrong hands?
I oblige all my partner states to uphold what is called the *principle of speciality*, meaning they can utilise the exchanged information solely for tax-related purposes, and they also need to ensure that sufficient data protection measures are in place. I want my procedure to be the blueprint for a uniform worldwide standard so no incompatibilities arise through the use of different models. I want to establish a so-called *level playing field*.

The early-adopter strategy is the best route a small country like Liechtenstein could have taken.

Do you really think this approach will work in actual practice?
The only sure things in life are death and paying taxes. My first allegiance is to my principals, and they want to see results. As I said before, I want to anchor my process as a global standard. But what the ultimate outcome actually might be? I do not know. So far, many of G20 member states, the OECD and the major financial centres have already given their blessing to the AEOI. Only the USA is dragging its feet at the moment, but I assume that at some point even the US will not resist the pressure from its foreign counterparts.

And how do you see things working out in terms of your principle of speciality and the data protection aspect?
That is a difficult issue indeed. By bundling data, one – willingly or not – skews the information symmetry, with the result being that it also fosters a power structure. So the question is justified as to whether the tax administrations of the involved countries can really cope with the gargantuan amount of data and related details. And with that, of course, whether it is giving an even heftier boost to bureaucratisation or, worse yet, an actual tax cartel. The exchanged datasets will be complex. Not only will it be necessary to painstakingly separate the relevant from the irrelevant; adopting a responsible attitude to the handling of the data will become increasingly important.

What is your take on Liechtenstein's early-adopter strategy?
The early-adopter strategy is the best route a small country like Liechtenstein could have taken. On the international stage, Liechtenstein is now recognised as a reliable and credible actor and has secured itself a legitimate say in how its future will be shaped. The move also obviates further external pressure. And so Liechtenstein, just like the other early-adopters, will commence with the automatic exchange of information as of mid-2017, whereas the data will pertain to the tax year that started on 1 January 2016.

Who exactly are the partner states of Liechtenstein?
Right up front, Liechtenstein concluded a multilateral agreement with the EU. Accordingly, all of the EU member states are the relevant partners of Liechtenstein when it comes to the AEOI. In the future, the Principality will need to negotiate specific agreements with other nations before any automatic exchange of tax information can take place. From what I know about Liechtenstein, that process will be conducted in a prudent and well thought out manner.

What does all of this actually mean for a Liechtenstein fiduciary?
Essentially, for purposes of reporting AEOI-relevant information to the Liechtenstein Tax Administration, a distinction is made between two types of entity: *financial institutions (FIs)* and *non-financial entities (NFEs)*. The former category includes banks, investment companies and insurers, but in certain instances asset structures are also deemed to be an FI, depending on their specific setup. NFEs on the other hand are – logically – those institutions that are not considered FIs. They include asset structures that have outsourced many of the normal business functions and are not professionally managed. However, asset structures are not generally allocated to either of those two

categories. Each asset base, each economic structure and each legal entity has to be analysed case-by-case in order to determine the proper classification. That points up the party who is liable for reporting, meaning the one who has to forward the appropriate information to the Liechtenstein Tax Administration. It could be a bank or a legal entity, and that in turn is decisive in the amount of information that needs to be reported. Liechtenstein fiduciaries must notify the account-holding local bank at latest by 31 December 2016 whether certain legal entities, based on their evaluated classification, will themselves report the exchangeable information to the Liechtenstein Tax Administration.

So what does this classification mean for, say, a foundation?
Depending on whether a foundation is classified as an FI or an NFE, the result can have a not insignificant influence on the amount of information that needs to be reported. For example, if a foundation is deemed to be an FI, then the fiduciary is obliged to report the relevant information. In the opposite case, it is the bank that has to report the so-called bankable assets. The major difference here lies in the classification: FI or NFE.

> The root cause of this call for an automatic exchange of information is the government debt crisis.

Dr Jekyll or Mr Hyde: which of those two characters best personifies your approach?
A provocative question, indeed, but not an uninteresting one. Let's scroll back a bit. What is the root cause of this call for an automatic exchange of tax-related information? The government debt crisis. Obviously when the coffers are empty, at some point the question arises: Where are we going to come by the cash we need without stealing it? So, one could view my appointment as being the last resort before the Big Bang; or maybe a symptom of the increasingly bureaucracy-driven rush towards centralisation. In both cases, I guess the character of Mr Hyde would be closer to the mark.

So something grim lurks behind all of this?
I would like to make a point here: Given the course of globalisation, it should surprise no one that wealth management has also become globalised, as have the underlying assets. So, one of the logical consequences is that countries have suffered a certain loss of their tax sovereignty. What I am trying to say is that, fundamentally, there is nothing – not even the state – that forbids you from holding your money in a foreign country. In end effect, this is simply the flipside of the globalisation coin. But it is the flipside some people simply have not taken into account.

And how do you feel about that?
I think that people who move their assets abroad probably have their justifiable reasons for doing so. And in the vast majority of those cases, the reasons are far different than the tax argument that is regularly run up the flagpole.

One last question: There already exist withholding tax regimes that take care of the tax collection aspect – why don't the powers just leave it at that?
The answer is relatively simple: Those systems do not produce information about assets held abroad. But the really interesting thing is precisely that information, not just the money.

The July 2014 issue of I&F News, which is accessible at *www.iuf.li > Publications 2014*, provides an overview of how the AEOI concept came into being. I&F News is published at irregular basis, yet always when relevant and interesting developments warrant commentary on our part.

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