Considerations for Family Offices in a changing tax regime – a global perspective

Foreword

Planning for tax volatility is crucial for family offices, given their often significant international exposure across a broad range of commercial interests, bankable investments or tax residence of family members. This paper looks at each tax area for consideration including: Corporation, Personal, Income, Inheritance, Capital Gains, Green, Social and Wealth Taxes. It puts forward recommendations that many family offices may need to consider when identifying and managing their current and future tax exposure, in an increasingly volatile tax environment including:

- Reviewing existing wealth structures to ensure that they are still "fit for purpose" and fully up to date regarding all tax compliance requirements. Consider tax structuring for all commercial transactions
- Identifying where there is a divergence of opinion between generations in attitudes towards tax and help to build a consensus
- Ensuring that governance frameworks within the Family Office and related entities/businesses, help to effectively manage tax risk in a transparent manner
- Be mindful of the reputation of the Family Office and how good tax governance and transparency can significantly enhance a Family Office's reputation. This is an increasingly important factor when participating in a process to acquire highly sought after assets

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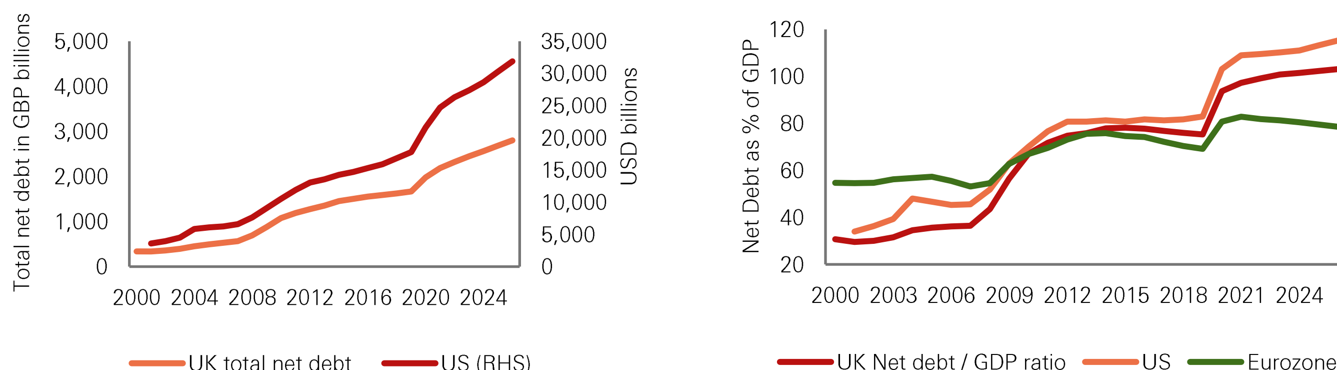
In the US and the UK, the total debt pile has been multiplied by more than 6 since 2000, and continues to grow.



The debt/GDP ratio jumped during the pandemic and during the GFC, and even austerity did not put a big dent into it.

Sources: IMF, HSBC Global Private Banking as at 10 October 2021.

Most families do not have the same leeway as governments to run up debt. Many countries have seen their debt loads reach new highs, both from an absolute perspective and relative to their income (or to GDP).

Of course, there is a valid excuse. The pandemic was exceptional, leading to a surge in spending, tax cuts and transfers that together often exceeded 10% of quarterly GDP. Support for companies and households helped them bridge a very difficult period and reduced the number of bankruptcies and personal defaults we would otherwise have seen. The bulk of these exceptional support measures will be temporary, but investment in healthcare, for example, will need to continue. Global ageing has not stopped, and the pandemic has illustrated that there has been a chronic underinvestment in many countries' health services. A probably even bigger area of public sector investment will be in climate mitigation and adaptation.

While spending and investment rose during the crisis, tax revenues fell. They are still lower than normal, as many companies are still recovering and supply chain issues hamper activity. Labour markets are showing shortages in some places, but for many workers, the transition to new jobs may take time as it often requires new skills.

Tightening fiscal policy seemed premature and dangerous so far, but some countries' GDP level is now back to the pre-crisis level. Quantitative easing "QE" also made it less urgent for governments to address their debt load, because it has removed some of the market discipline, especially for developed market sovereigns. But as QE programmes come to a gradual end in the US and the UK, some of that market discipline may return.

It may not be a coincidence, therefore, that the US and the UK have now started to signal to voters and markets that their deficits need to shrink, through spending cuts and tax increases. The latest US budget reconciliation bill proposes that the additional spending will be partly paid for by taxes on companies and higher earners. In the UK, the government has introduced a new health and social care levy from 2022, the withdrawal of the super deduction investment incentive and a 6% hike in corporation tax in 2023. In the EU, there may be less urgency to raise taxes as the EUR750bn Next Generation EU fund can help fund expenditure. And in China, targeted fiscal support measures for the private sector are expected to remain in place. But in several emerging markets where deficits rose from 2020 to 2021, fiscal consolidation is being promised to markets.

So while there seems to be a gradual return to some fiscal orthodoxy, the extent and the speed of it varies by country. Tightening both fiscal and monetary policy at the same time can hurt activity and market confidence, and it is one of the reasons why we expect the US and UK central banks to end their cycle of rate increases after just 2 or 3 hikes.

How much will come from the taxes (i.e. the income side) will vary by country too. Politics may play a part here, the judgment of what is fair, and the lessons learned from austerity following the great financial crisis. The US and the UK plans include some of the possible trends we could see: taxes on higher earners, wealthy households or large corporations to pay for transfers to the less fortunate and for investment to address the demographic trends and climate crisis. Carbon taxes are another area that will be interesting to watch. As interest rate costs are bound to rise at some point, and global ageing will result in lower tax collection if nothing is done, it seems unavoidable that tax rates will be on the rise for some time to come.

Against the backdrop of the above, family offices face increasingly complex scenarios when planning for their founders and key family members - who are often globally mobile, with the ability to be resident in any number of

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jurisdictions, but often with a preference as to where they decide to settle.

Recent elections in the UK, US and Germany have seen battle lines drawn over taxes, the perception of fairness and simply governments needing to raise revenue to fund election promises and recover the cost of the pandemic support they have provided to households and businesses.

Corporation Tax

Globally there is a focus on corporation tax. The OECD announced in July 2021[1] that 130 countries and jurisdictions have joined a new two-pillar plan to reform international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate.

A recent example of this is the UK, which announced in its most recent budget that corporation tax will increase from 19% to 25% from April 2023 - where profits exceeded as little as £250,000 per annum. Perhaps more telling was that this rate was also to apply to companies used to manage family investments.

Even with a corporation tax rate of 25% the UK remains competitive, research from the Tax Foundation[2] shows that with the average corporate tax rate, measured across 177 jurisdictions, is 23.85%. When weighted by GDP, the average statutory rate is 25.85%.

Drive for transparency

The latest OECD initiative on corporation tax simply drives home the direction of travel. Global initiatives such as the Common Reporting Standard "CRS" and Foreign Account Tax Compliance Act "FATCA" all underline the focus that governments have on ensuring their residents (or citizens) are correctly declaring income, gains and their wealth generally.

Families who organise their finances through family offices, often manage their wealth with structures that have been designed to smooth the transition of wealth through multiple generations, may find themselves subject to even greater levels of scrutiny.

With the transition of wealth to the next generation over the next 10 years, estimated to run into the trillions[3], it is anticipated that families will be revisiting their structures to ensure that they not only remain compliant with all global and domestic initiatives, but that they are consistent with the vision and values that the next generation have for the family wealth which may well be different to that of the previous generation.

Personal taxation

Globally governments have moved away from supporting businesses and households, as they did during the first half of the pandemic, when the focus was on providing relief. Whilst the effects of the global pandemic have begun to ease the global trend is clear. Tax policy reforms have to be expected as do tax increases, as governments seek to recover the costs of the support that has been provided and to invest for the future.

Income tax

Here the playing field is far from level. Some jurisdictions apply rates of income tax close to 56% whereas others apply a 0% rate to income and gains[4].

Those in control of tax policy have to balance the global mobility of their wealthiest residents; the perception of tax fairness versus the reality that in order to raise meaningful levels of revenue it is by increasing the median rates of tax (where the overwhelming majority of taxpayers sit) that will have the greatest impact in terms of raising revenue, and therefore such an approach may be viewed as socially unacceptable.

Research again shows us that increasing tax rates[5] often has the effect of actually collecting less revenue than at lower rates, those with high levels of wealth adjust their behaviour, refining the approach for policy makers is therefore far from simple.

Furthermore, the landscape for wealthy individuals and families is competitive, many countries offer special tax regimes to those who are prepared to pay annual contributions to the tax authorities in return for access to favourable tax regimes.

With countries such as Italy and Greece introducing their own special tax regimes for those relocating there (provided the certain conditions are met) the landscape is becoming increasingly competitive. The UK has the remittance basis of taxation, which has been subject to a number of changes in recent times, but this is expected to remain in place and unchanged, at least for the term of this parliament and perhaps the next (assuming a workable majority for the Conservative Party at the next election).

[1] Date: 01/07/2021. OECD Webiste. Article: 130 countries and jurisdictions join bold new framework for international tax reform, OECD

[2] Date: 09/12/2020: taxfoundation.org. Article: Corporate Tax Rates Around the World, Tax Foundation

[3] Date: 26/06/2019. Wealthx.com. Article: A Generational Shift: Family Wealth Transfer Report 2019

[4] Date: 2020. Stats.oecd.org. Article: Table I.7. Top statutory personal income tax rates. Date: 2021. Home.kpmg. Article: Individual income tax rates table, KPMG Global.

[5] Date: 22/08/2017. Ifs.org.uk. Article: How do the rich respond to higher income tax rates?

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Estate and Inheritance Taxes

Often family offices are established as a means to manage the interests of an individual or their broader family. As time passes the focus often moves to succession, to the next generation, and with that concerns over how the beneficiaries may be taxed and if the structures used to manage the wealth and succession are appropriate, or if they should be refreshed.

Again the playing field is far from level. Some jurisdictions do not levy any estate or inheritance taxes, with others charging rates of 60% and beyond[6].

In the UK, where inheritance tax is generally payable at 40% (on all but a small proportion of the estate), there have been various reviews of the inheritance tax system all with a view to refreshing this tax and perhaps driving tax receipts from this tax upward – it currently raises very little in the way of revenue, when compared to say income tax. Families offices would be well advised to ensure their arrangements are reviewed regularly and refreshed as appropriate.

Capital gains tax

Some jurisdictions treat short term gains like income and tax them as such, whilst offering a deduction based on length of ownership or apply different rates to different types of gains.

In counties where there is a significant disparity, such as in the UK (45% income tax versus 20% or 28% capital gains tax), capital gains tax may be considered low hanging fruit.

Should capital gains tax rates rise in counties such as the UK, then family offices may increasingly look to new vehicles to manage the family wealth, such as POEICs or SICAVs, which allow the investors to control tax points and roll up capital gains within the investment wrapper.

What are the alternatives?

Social taxes

The pressure on healthcare services at the height of the pandemic was evident, with essential treatments being unavailable as those caring for CV19 patients simply did not have the resources (or capacity) to provide what might be considered to be a basic level of care in many nations.

Taxes to assist with funding healthcare provision is certainly not a new concept. Many countries already apply specific levies, sometimes referred to as contributions under this guise. The question policy makers will be asking themselves "is there scope to increase these". The answer appears to be yes. Most recently in the UK (a country where national insurance contributions are perceived as assisting with the funding of healthcare services) they announced a new social and healthcare levy of 1.25%, which will apply to employees, employers and dividend income, with the revenue this new tax raises being earmarked for social and healthcare.

Wealth Tax

In 1990, 12 countries in Europe had a wealth tax[7&8]. Today, there are only a handful.

Generally, wealth taxes are politically popular, only impacting a small percentage of the voter base and in some countries payable by those who are unable to vote but have assets there (most commonly for real estate).

Perhaps the French model of seeking to only tax real estate removed (to some degree) the complexities that tax authorities face in valuing assets, or implementing a one off wealth tax, as proposed by the (self-appointed) UK Wealth Tax Commission[8].

Green taxes

As the revenue raised by taxing fossil fuels continues to drop and other forms of transport, such as electric vehicles, become increasing popular and accessible, then perhaps the government will look to tax these methods of transport in some way.

The future

Clearly it is impossible to predict how policymakers will decide to tackle the issue faced by unprecedented levels of borrowing, however, it is clear that doing nothing is unlikely to be an option.

Given that many family offices will often have significant international exposure, whether it be in respect to their commercial interests, bankable investments or the tax residence of individual family members, it would sensible to:

- Review existing wealth structures to ensure they remain "fit for purpose" and fully up to date regarding all tax compliance requirements
- Consider tax structuring for all commercial transactions
- Identify where there is a divergence of opinion between generations in attitudes towards tax and ensuring that governance frameworks within the Family Office help to effectively manage tax risk in a transparent manner and build consensus

To be mindful of the reputation of the Family Office and how good tax governance and transparency can significantly enhance a Family Office's reputation.

[6] Date: 15/0/2021. Oecd-ilibrary.org. Article: Inheritance, estate, and gift tax design in OECD countries | Inheritance Taxation in OECD Countries

[7] Date: 2018. Read.oecd-ilibrary.org. Article: The Role and Design of Net Wealth Taxes in the OECD, OECD iLibrary

[8] Date: 2020. Wealthandpolicy.com. Article: A wealth tax for the UK, Wealth Tax Commission

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